Denver Law Review

Volume 73 | Issue 2 Article 8

January 2021

Vol. 73, no. 2: Full Issue

Denver University Law Review

DENVER UNIVERSITY LAW REVIEW

VOLUME 73

1995-1996

Published by the
University of Denver
College of Law

DENVER UNIVERSITY LAW REVIEW

1996 Volume 73 Issue 2

TABLE OF CONTENTS

ARTICLES

NOTE

COMMENT

FIDELITY TO THE WARRANT CLAUSE: USING MAGISTRATES, INCENTIVES, AND TELECOMMUNICATIONS TECHNOLOGY TO REINVIGORATE FOURTH AMENDMENT JURISPRUDENCE

DONALD L. BECI*

INTRODUCTION

Today, Government officials performed an early morning warrantless search of a local handyman's home. At 2:10 a.m. police kicked in the door of his house and riddled the dwelling with 183 bullets. Mr. Durwood Foshee was shot and killed, apparently while still in bed. The mistaken raid location, chosen on the basis of an informant's erroneous tip, took place without the constitutional safeguard of a warrant. The search was performed under one of the exceptions to the warrant requirement allowed by the Supreme Court. In this case the reasoning was that the agents did not have the time or geographic ability to obtain a warrant.[1]

In this modern day of electronics and computers, we foresee a time in the near future when the warrant requirement . . . can be fulfilled virtually without exception. All that would be needed . . . would be a central facility with magistrates on duty and available 24 hours a day. All police . . . could call in by telephone or other electronic device . . . . The magistrates would evaluate [the] facts and, if deemed sufficient to justify a search and seizure, the magistrate would immediately issue an electronic warrant authorizing the officer on the scene to proceed.[2]

---

* Associate Professor of Law, Norman Adrian Wiggins School of Law, Campbell University. B.A., University of Illinois, 1977; M.A., University of Illinois, 1978; J.D., University of Illinois College of Law, 1984. The author gratefully acknowledges Gerard V. Bradley and Sheldon H. Nahmod for their helpful comments on an earlier draft of this article. Lee Cumbie and Shannon Hall provided excellent research assistance. Furthermore, Austyn, Jenna, and Rose Beci are especially deserving of thanks, as they provided the inspiration and sacrifices that made this article possible.

1. *See* Susan Watson, *A Little Stress Would Be Too Much*, DET. FREE PRESS, Jan. 16, 1989, at 3A. Had the police first sought a warrant, a neutral and detached magistrate could have prevented the search. The magistrate would have denied the warrant if—after reviewing all of the facts, including the source of the erroneous tip—the magistrate concluded that either probable cause was lacking or that the anticipated police conduct was unreasonable. *See infra* part III.A.

2. State v. Brown, 721 P.2d 1357, 1363 n.6 (Or. 1986).

Searches by government agents should normally be conducted with, rather than without, pre-approved judicial warrants. The Fourth Amendment's Warrant Clause provides an essential safeguard against government tyranny and capriciousness.[3] The warrant requirement maintains the Fourth Amendment's delicate balance between the liberty and privacy interests of each citizen and the safety and security needs of the public. Additionally, the warrant requirement is consistent with the original intent of the Framers of the Constitution to limit the government's discretion to search and seize.[4] For more than a century the Supreme Court has stressed the importance of the warrant requirement.[5]

Today, however, the Court seems more willing to disregard the Warrant Clause and instead focus its decisions exclusively on an analysis of the reasonableness clause.[6] During the past thirty years, the Court has increasingly created various exceptions to the warrant requirement.[7] Indeed, instead of a general warrant requirement with specific exceptions, one Justice recently submitted

---

3. The Fourth Amendment reads:

> The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

U.S. CONST. amend. IV.

4. The Framers did acquiesce, however, in limited types of warrantless searches that were then permitted under the common law. At the time the Fourth Amendment was drafted, an official could make a *public arrest* and conduct a *search incident to arrest* without a warrant. *See infra* text accompanying notes 43-44. This article does not propose that either of these two exceptions to the warrant requirement be modified or eliminated. The focus of this article is not on those warrantless searches and seizures permitted when the Fourth Amendment was drafted, but on the increasing amount and variety of warrantless conduct that has subsequently been permitted.

The first of these two exceptions, a warrantless public arrest, is not inconsistent with this article's thesis: due to the actual—and not simply theoretical—exigency which is inherent in the arrest situation, a government agent should be permitted to make a public arrest without a warrant. *See generally* United States v. Watson, 423 U.S. 411 (1976) (allowing a warrantless felony arrest in public).

While a thorough examination of the second exception, search incident to arrest, is beyond the scope of this article, it is also generally consistent with this article's thesis: an officer should generally be permitted to conduct this type of search without a warrant due to the danger that the arrestee might harm the officer or another person with a concealed weapon or destroy evidence. *See generally* Chimel v. California, 395 U.S. 752 (1969) (permitting a warrantless search incident to a lawful arrest but limited to the person and the area from which they could obtain a weapon or destroy evidence).

The search incident to arrest doctrine is also an exception to the probable cause requirement. A convincing argument can be made that the exception to the probable cause requirement should be limited to those situations where one of the exigent circumstances supporting the exception is actually present, and not just theoretically possible. *See generally* Tim A. Thomas, Annotation, *Constitutionality of Searching Premises Without Warrant as Incident to Valid Arrest—Supreme Court Cases*, 108 L. Ed. 2d 987 (1992) (discussing whether a warrantless search of premises is constitutionally permissible as an incident to a valid arrest). In contrast, searches incident to arrest are being permitted without warrants even in situations where the arrestee can neither destroy evidence nor harm anyone. *See, e.g.*, New York v. Belton, 453 U.S. 454, 466 (1981) (Brennan, J., dissenting) ("As the facts of this case make clear, the Court today substantially expands the permissible scope of searches incident to arrest by permitting the police officers to search areas and containers the arrestee could not possibly reach at the time of the arrest.").

5. *See infra* text accompanying notes 67-93.

6. *See infra* text accompanying notes 183-87.

7. *See infra* text accompanying notes 94-107.

that a warrant should only be required when a case-by-case analysis indicates that it is necessary to satisfy the reasonableness requirement.[8] The Court has also been increasingly willing to abandon the warrant requirement, as well as other Fourth Amendment threshold requirements, by engaging in a "special needs" analysis.[9] These exceptions have become so numerous that the warrant requirement has become eclipsed by its exceptions.[10] Consequently, the Court has, in many instances, sacrificed the vital safeguards provided by the warrant requirement.

However, with current computer and electronic telecommunications technology, police officers can now swiftly obtain a warrant without leaving the area of investigation. Miniaturization of computer hardware, cellular facsimiles, the direct transmission of electronic documents between cellular computer modems, and other associated technologies, have changed the face of modern communications. What was not feasible ten years ago is now viable due to developments in computer and electronic telecommunications technology. These developments should usher in a renewed commitment to the warrant requirement.

Part I of this article identifies advancements in available computer and electronic telecommunications technology, and suggests how this technology can be used to satisfy the warrant requirement. Advances in technology not only permit a renewed and robust commitment to the warrant requirement, but also enable the Supreme Court to correct previous encroachments on Fourth Amendment principles.

Part II examines the historical evidence in support of the warrant requirement and in opposition to government searches without pre-approved judicial warrants.[11] This Part first argues that the original intent of the Framers of the Constitution favors a renewed and meaningful commitment to the warrant requirement. Part II then considers key Supreme Court decisions regarding the Warrant Clause over a one hundred year period. Finally, this Part argues that

---

8. California v. Acevedo, 500 U.S. 565, 584-85 (1991) (Scalia, J., concurring).

9. *See infra* text accompanying notes 183-87.

10. Most of these exceptions were initially based on exigency, which applies when government agents do not have the time or geographic ability to obtain a warrant due to the urgency surrounding the search or seizure. *See also* Michigan v. Tyler, 436 U.S. 499 (1978) (explaining that burning fire creates exigency); United States v. McDonald, 916 F.2d 766 (2d Cir. 1990) (holding that exigent circumstances existed due to imminent threat of loss of evidence), *cert. denied*, 498 U.S. 1119 (1991); United States v. Riccio, 726 F.2d 638 (10th Cir. 1984) (explaining that entry was justified because officers had a reasonable belief that an individual had been shot); United States v. Bell, 335 F. Supp. 797 (E.D.N.Y.) (permitting magnetometers in airports by balancing the need for airline safety against the minimal intrusion upon individual privacy), *aff'd*, 464 F.2d 667 (2d Cir.), *cert. denied*, 409 U.S. 991 (1972). *See generally* United States v. McConney, 728 F.2d 1195, 1199 (9th Cir.) (defining exigency as "circumstances that would cause a reasonable person to believe that entry (or other relevant prompt action) was necessary to prevent physical harm to the officers or other persons, the destruction of relevant evidence, the escape of a suspect, or some consequence improperly frustrating legitimate law enforcement efforts"), *cert. denied*, 469 U.S. 824 (1984).

11. The thesis of this article focuses on *judicial* warrants. Administrative warrants, such as those used to inspect for compliance with building codes, are not addressed. For a discussion of administrative warrants, see generally Bernard A. Nigro, Jr., Note, *The Exclusionary Rule in Administrative Proceedings*, 54 GEO. WASH. L. REV. 564 (1986).

it is more consistent with enduring Fourth Amendment jurisprudence to require that searches be conducted with warrants.

Part III identifies several advantages that flow from government compliance with the warrant requirement. This Part also acknowledges that, for the identified advantages to emerge, the magistrate's check must be more than a mere affirmative and spontaneous reflex to the agent's request to search. Therefore, Part III argues that the warrant process must be strengthened to ensure that the magistrate provides a meaningful control on the government's unchecked discretion. Specific methods are discussed for catalyzing the warrant process so as to make the magistrate's assessment more meaningful.

Part IV argues that Congress, state legislatures, and the courts should implement substantive and procedural incentives to encourage the use of the warrant process. Likewise, disincentives must be introduced to discourage agents from engaging in warrantless searches or seizures. The incentives and disincentives discussed involve changes to the following: an agent's liability for conducting an unconstitutional search; the time available to a victim to make a suppression motion; the burdens of production and persuasion applicable in a suppression hearing; the prosecutor's ability to obtain immediate appellate review of a trial court's suppression ruling; and the class of victims who have standing to challenge a search.

Part V proposes alternatives to current exceptions to the warrant requirement, and warns against the creation of a new exception to the exclusionary rule. Specifically, this Part examines existing exceptions to the warrant requirement and argues that the exceptions should be eliminated or narrowed due to the availability of electronic warrants. Second, Part V argues that compliance by government agents with the warrant requirement eliminates the need for either Congress or the courts to create a new "good faith" exception to the exclusionary rule for searches or seizures conducted without warrants. Noting that the existing *Leon*[12] "good faith" exception already permits the use of unconstitutionally-obtained evidence against a criminal defendant if it has been seized with a warrant, this section argues that an additional "good faith" exception is not only unnecessary, but is also harmful because it abolishes any significant control on the discretion of government agents to search and seize.

I. DEVELOPMENTS IN COMPUTER AND ELECTRONIC TELECOMMUNICATIONS TECHNOLOGY

Current technology includes portable and lightweight cellular facsimile machines. This equipment can be used by an officer in the field or in a squad car.[13] With a cellular facsimile machine, the officer can quickly, and without

12. United States v. Leon, 468 U.S. 897 (1984).

13. One example of a cellular facsimile machine is the Mitsubishi F15 Access Cellular Fax Machine available from Sprint Cellular. It is small (12.5" x 8" x 2.4"), lightweight (about 6.5 lbs.), and is powered by an AC adapter plugged into the car cigarette lighter. It can be wired directly into the vehicle's electrical system for a permanent installation. The machine operates on an existing cellular phone line and automatically differentiates between voice and data transmissions. Production has already begun on a newer, smaller, more advanced model. Telephone inter-

leaving the investigation area, transmit a written warrant application and affidavit to the magistrate. The magistrate can then transmit the approved warrant back to the officer. The Federal Rules of Criminal Procedure and the procedural rules in a number of states have been amended recently to permit facsimile transmission.[14] Reviewing courts have upheld the constitutionality of warrants obtained through the facsimile procedure.[15] These machines are now rather standard in the industry and are relatively inexpensive for government agencies to purchase. Unlike cellular computers, cellular facsimile machines do not require the purchase of computers.

Current technology also permits electronic transmission directly between cellular computer modems. Many police vehicles are presently equipped with laptop computers or motor data terminals.[16] Law enforcement officers can be supplied with portable and lightweight palm computers or personal digital assistants.[17] These computers can transmit both the warrant application and

---

view with Diane McIlnay, Account Executive, Sprint Cellular (May 11, 1995).

14. *See* FED. R. CRIM. P. 41(c)(2)(A) ("If the circumstances make it reasonable to dispense, in whole or in part, with the written affidavit, a Federal magistrate judge may issue a warrant based upon sworn testimony communicated by telephone or other appropriate means, including facsimile transmission."); ALASKA STAT. § 12.35.015(a) (Supp. 1991) (permitting sworn affidavits to be transmitted via facsimile machine); CAL. PENAL CODE § 1526 (West Supp. 1995) (permitting application for, and issuance of, facsimile warrants); COLO. R. CRIM. P. 41(c)(1)(iv)(3) (allowing the judge to "act upon the transmitted papers as if they were originals"); DEL. J.P. CT. CRIM. P. 4.2(c) ("The Court may accept the filings of pleadings designated in this rule [including search warrants] by facsimile transmission in conjunction with videophone appearance."); IDAHO CRIM. R. 41 (allowing a warrant to be transmitted by facsimile from magistrate back to peace officer); ILL. REV. STAT. ch. 725 para. 5/108-4 (1992) ("The search warrant may be issued electronically or electromagnetically by use of a facsimile transmission machine and any such warrant shall have the same validity as a written search warrant."); MINN. R. CRIM. P. 33.05 ("[A] facsimile order or warrant issued by the court shall have the same force and effect as the original."); R.R.S. NEB. § 29-814.03 (1994) subject to NEB. CT. R. Fax Machine Use Rule (1994) (permitting facsimile warrants when immediacy is required); S.D. CODIFIED LAWS ANN. § 23A-35.4.2 (Supp. 1995) (allowing for facsimile transmission and requiring that original documents be filed with the court within five business days).

15. *See* People v. Fournier, 793 P.2d 1176 (Colo. 1990) (upholding a facsimile application and warrant where all magistrates were out of town at a judicial conference); People v. Paul, 511 N.W.2d 434, 435 n.2 (Mich. 1994) (Levin, J., dissenting) (discussing "widespread use of facsimile equipment in recent years" and looking favorably upon facsimile warrants); People v. Snyder, 449 N.W.2d 703 (Mich. Ct. App. 1989) (upholding a warrant where officer called magistrate at home and transmitted unsigned warrant documents to magistrate's home via facsimile, and magistrate approved and returned warrant by facsimile to officer.); *see also* FED. R. CRIM. P. 41(c)(2)(A) advisory committee's note on 1993 amendment ("[F]acsimile transmissions provide some method of assuring the authenticity of the writing transmitted by the affiant."). For a general survey of facsimile machine use in the judicial system, see MONICA R. LEE, NATIONAL CENTER FOR STATE COURTS, FACSIMILE TRANSMISSION OF COURT DOCUMENTS: A FEASIBILITY STUDY 1990.

16. As an example, the North Carolina Highway Patrol and the Charlotte-Mecklenburg Police Department (N.C.) presently use in-car computers for various tasks. Telephone interview with Larry Blume, Systems Programmer, Charlotte-Mecklenburg Police Department (June 12, 1995). In addition, throughout the area of North Carolina known as the "Research Triangle," which includes Wake County, the city of Durham, the city of Raleigh, and the towns of Cary, Chapel Hill, and Garner, laptops and/or motor data terminals (MDTs) are being used. Elizabeth Wellington, *Machines Help Cary Police Take Byte Out of Crime: In-Car Computers Ease Officers' Jobs*, NEWS & OBSERVER (Raleigh, N.C.), July 31, 1995, at B1.

17. A hand-held computer can be either a personal digital assistant (PDA), which is accessed with a pen rather than a keyboard, or a palm computer, which is accessed via a keyboard. One example of a currently available, suitable, portable, lightweight palm computer is the Hewlett Packard HP 200 LX. It has the processor capability to run a graphics program which would allow

the approved warrant electronically—directly from the officer's computer to the magistrate's computer and then back again—through a cellular modem. The confidentiality of these transmissions can be protected through the use of existing encryption technology.[18] If a paper copy of the issued warrant is desired, a portable printer can be used.[19] Electronic copies of the application and the warrant can be routinely and automatically retained, one on the magistrate's hard drive and the other on the agent's computer. For security and historical accuracy, the magistrate's hard drive could also be systematically copied and inventoried. Procedural rules in some states have already been amended to permit use of such electronic transmission.[20] Courts that have addressed warrants obtained via electronic transmission suggest that there are no constitutional impediments to their use.[21] One unresolved detail that must be addressed is the development of a method to authenticate one's electronic signature.[22] Such authentication is necessary to satisfy the requirement that the affiant's information be provided under oath or affirmation.[23] It is this

---

an officer to view and complete the warrant application on the screen, a modem to transmit the application to a magistrate for approval and receive the approved warrant back, and a printer port which could be used with a portable printer to produce a hard copy of the approved warrant. It also has the capability to utilize a portable scanner to input a handwritten application. The physical dimensions of the HP 200 LX are 16 x 8.64 x 2.54 (cm). It weighs approximately 11 ounces. Telephone interview with Lucy Honig, Product Manager, Hewlett Packard (Aug. 9, 1995).

18. Various software programs exist which allow for encryption of text prior to transmission via facsimile or modem. Alternatively, existing hardware also can be used to scramble the output of the cellular transmission. Encryption rearranges the order of the transmission signals into an unintelligible format which prevents anyone who intercepts a transmission from understanding the contents. A decryption device is used at the receiver to rearrange the transmission signals so they may be understood. Technology would prevent sophisticated criminals from monitoring police requests for warrants, denying them the opportunity to dispose of any incriminating evidence prior to a search. *See generally Cryptology, in* 16 THE NEW ENCYCLOPEDIA BRITANNICA 860 (15th ed. 1995) (discussing various methods to secure communications).

19. The Hewlett Packard HP 320 Portable Deskjet Printer is one example. It is available in black/grey scale or color printing options, 300 dpi resolution, and it prints at about 3 pages per minute. The unit easily fits into a briefcase. Its dimensions are 12"W x 9.5"D x 2.5"H. Telephone interview with Lucy Honig, *supra* note 17.

20. *See, e.g.*, ARIZ. REV. STAT. ANN. § 13-39149(c) (1989) ("telephone, radio or other means of electronic communication"); LA. CODE CRIM. PROC. ANN. art. 162.1 (West Supp. 1995) ("may be communicated . . . by telephone, radio, or other such electronic method of communication deemed appropriate by the judge"); OKLA. R. WSDCND W.D.R. 36 (1995) ("telephone or other appropriate means"); UTAH CODE ANN. § 77-23-204 (1995). *But see* FED. R. CRIM. P. 41(c)(2)(A) advisory committee's note on 1993 amendment ("The Committee considered, but rejected, amendments to the Rule which would have permitted other means of electronic transmission, such as the use of computer modems.").

21. *See, e.g.*, California v. McCraw, 276 Cal. Rptr. 208 (Cal. Ct. App. 1990) (holding that a warrant sent electronically from Washington to California is as effective as the original).

22. Software technology currently exists which allows the user to actually sign the computer screen with a special pen (i.e. a screen signature). The signature is then added directly into the electronic document. Another option is a scanner which would input the signature into the document prior to transmission. Telephone interview with Lucy Honig, *supra* note 17.

23. This problem has already been resolved when a warrant is obtained via facsimile or telephone transmission. Courts have upheld oaths taken over the phone, by a third party, or at a later date. *See, e.g.*, Mills v. Graves, 930 F.2d 729 (9th Cir. 1991) (holding telephonic search warrant valid even where oath was taken five days later); People v. Fournier, 793 P.2d 1176 (Colo. 1990) (explaining that facsimile warrant was valid where oath was taken by clerk of court prior to facsimile transmission); People v. Paul, 511 N.W.2d 434, 449 n.2 (Mich. 1989) (Levin, J., dissenting) (recognizing that a magistrate may "orally administer an oath or affirmation by telephone"). Unlike oral telephone warrants, however, these additional steps are arguably unnecessary

technology, permitting a police officer to apply for a warrant electronically via a cellular modem on a small computer located within the squad car, that this article prefers. The production and transmission of electronic documents directly between computer modems would be quicker than the facsimile procedure described above and would eliminate legibility problems. In addition, this application is not as experimental as the miniaturized computers, which are discussed next.

Ongoing miniaturization of computer hardware increasingly facilitates the use of computer warrants. Computers have decreased in size from desktop to laptop, laptop to notebook, and notebook to personal digital assistant. Moreover, a wearable computer, which can be clipped to one's belt, is now available.[24] A wearable computer is a miniaturized version of an IBM-compatible 486 and, along with its battery, weighs less than three pounds.[25] The computer is voice-activated and has no keyboard.[26] It was designed for hand-free operation, but can also be accessed with a small mouse.[27] While the monitor measures only one-half inch in diameter, it produces a display which appears much larger.[28] Police should not be required to possess wearable computers until further study determines if this equipment can be used without interfering with an officer's mobility.[29] But the availability of this hardware today is an encouraging sign that numerous possibilities for electronic warrants will be available in the near future.

Today's technology frees the Supreme Court from the dilemma in which it has been mired. The Court no longer must choose between the warrant requirement, which protects liberty interests, and warrantless searches, which permit the government to move swiftly in exigent circumstances. An effective warrant process can be reclaimed and preserved, and the officer can proceed quickly without leaving the area of investigation.

---

when a warrant is requested via facsimile transmission. The oath or affirmation requirement is satisfied when the magistrate receives a facsimile copy of the affiant's signature formally attesting to the truth of the statements in the warrant application.

24. The wearable computer was developed by and is available from InterVision Systems Inc., Raleigh, N.C. It was designed to be used with an attached video camera by service technicians in the field, and it has been purchased by the Army after being tested during war exercises. David Ranii, *The Ultimate in Computer Portability: Raleigh Firm Makes Wearable Computer*, NEWS & OBSERVER (Raleigh, N.C.), Aug. 5, 1995, at D1. In addition, federal law enforcement agencies, including the Federal Bureau of Investigation and the Drug Enforcement Agency, are presently considering its surveillance applications. Telephone Interview with John Lontos, Cofounder, InterVision Systems Inc. (Aug. 5, 1995).

25. It is likely that wearable computers will weigh even less in the future considering the current version weighs half as much as the previous model. Ranii, *supra* note 24, at D6.

26. *Id.* at D1.

27. *Id.*

28. *Id.* The monitor is attached to the user's cap or helmet, and can be ignored without obstructing the user's regular vision. *Id.*

29. The price of the wearable computer—between $8,000 and $12,000—may also be an obstacle to its current use. But the price is likely to be reduced as anticipated competitors enter the market. The price has already been reduced from its original price of $20,000. *Id.* at D6.

II. HISTORICAL EVIDENCE IN SUPPORT OF THE WARRANT REQUIREMENT

A. *The Warrant Requirement Is Consistent with the Framers' Intent to Limit Government Discretion to Search and Seize*[30]

The Framers' original intent when creating the Fourth Amendment of the Bill of Rights is consistent with a renewed and meaningful commitment to the general principle that a government agent must first obtain a warrant before conducting a search or seizure. Even though the Framers implicitly approved of certain types of warrantless searches,[31] the Framers' overriding intent was to limit the government's general discretion to search and seize.[32]

While many legal historians have attempted to comprehend the mosaic of what the Framers meant by the Amendment,[33] they have reached dissimilar conclusions.[34] These scholars generally agree that the Amendment was intended as a means of controlling governmental intrusion into an individual's privacy.[35] Legal historians disagree, however, as to how the Framers foresaw that the Amendment would accomplish this purpose. Some have concluded that the Framers intended that the Amendment prohibit any search or seizure conducted without a warrant. Others have concluded that the Framers intended that the absence of a warrant be only one factor considered in determining whether the search or seizure is reasonable and therefore constitutional.[36] This

---

30. The author gratefully acknowledges Lee Cumbie for his research, suggestions, and contributions to this section.

31. *See supra* note 4.

32. There are many early writings warning of the danger that the government may usurp power and intrude on individual liberties. *See* THE FEDERALIST No. 84, at 79 (Alexander Hamilton) (Jacob E. Cooke ed., 1961) (warning against giving to "men disposed to usurp, a plausible pretence for claiming that power"); 21 DEBATES IN THE SEVERAL STATE CONVENTIONS ON THE ADOPTION OF THE FEDERAL CONSTITUTION 445-49 (Jonathan Elliot ed., 1881) (quoting Patrick Henry's warning against the terrors of federal authority without a protective bill of rights); John Adams, *Petition of Lechmere: Adam's "Abstract of the Argument", reprinted in* 2 LEGAL PAPERS OF JOHN ADAMS 134, 142-44 (L. Kinven Wroth & Hiller B. Zobel eds., 1965) (condemning the abuse of power that resulted from the use of general warrants and writs of assistance).

33. An in depth discussion of the historical events leading up to the Fourth Amendment is beyond the scope of this article. For thorough attention to this history, see generally JACOB W. LANDYNSKI, SEARCH AND SEIZURE AND THE SUPREME COURT (1966); NELSON B. LASSON, THE HISTORY AND DEVELOPMENT OF THE FOURTH AMENDMENT TO THE UNITED STATES CONSTITUTION (1937); JOSIAH QUINCY, JR., REPORTS OF CASES ARGUED AND ADJUDGED IN THE SUPERIOR COURT OF JUDICATURE OF THE PROVINCE OF MASSACHUSETTS BAY, BETWEEN 1761-1772 (1865); TELFORD TAYLOR, TWO STUDIES IN CONSTITUTIONAL INTERPRETATION (1969).

34. *Compare* Anthony G. Amsterdam, *Perspectives on the Fourth Amendment*, 58 MINN. L. REV. 349 (1974) (generally viewing exceptions to the warrant requirement as granting too much discretionary power to law enforcement officers) *and* LANDYNSKI, *supra* note 33, at 42-44 (advocating that it clearly was not the Framers' intent to allow judicially created exceptions to the warrant requirement except in compelling circumstances) *with* TAYLOR, *supra* note 33, at 46-47 ("[Those] who have viewed the fourth amendment primarily as a requirement that searches be covered by warrants, have stood the amendment on its head. Such was not the history of the matter, such was not the original understanding.") *and* Akhil R. Amar, *The Bill of Rights as a Constitution*, 100 YALE L.J. 1131, 1179 (1991) ("We can now see the Fourth Amendment with fresh eyes. Searches without warrants are not presumptively illegitimate. Rather . . . a jury could subsequently assess its reasonableness.").

35. *See supra* note 33.

36. *See supra* note 34; *see also* California v. Acevedo, 500 U.S. 565, 581-83 (1991) (Scalia, J., concurring); Coolidge v. New Hampshire, 403 U.S. 443, 474-75 (1971).

article suggests that the positions are at the same time both accurate and inaccurate. Furthermore, this article contends that *today* the Framers' original intent is best satisfied through the warrant requirement.

Historical certainty as to the Framers' precise meaning of the Amendment's terms may never be obtained.[37] Such a microscopic inquiry may be counterproductive. As noted by Alexander Hamilton in his initial opposition to the Bill of Rights: "[M]inute detail of particular rights is certainly far less applicable to a Constitution like that under consideration, which is merely intended to regulate the general political interests of the nation, than to a constitution which has the regulation of every species of personal and private concerns."[38]

An historical inquiry into the Framers' general intent, their purpose in creating the Amendment, and their desires as to what the Amendment was to accomplish would be more productive than a detailed study of the Amendment's specific terms. Only by understanding the dangers and threats to individual liberty that the Framers were attempting to avoid, can one interpret and apply the Fourth Amendment with genuine deference to the Framers' original intent.

This article suggests that the Framers of the Constitution had a three-tiered approach in mind when promulgating the Fourth Amendment. First, the Framers implicitly approved of the status of the limited types of warrantless searches permitted under the common law at the time.[39] Arguably, this approval was based on the assumption that common law remedies, such as suits for trespass and false imprisonment, would continue to prevent such warrantless searches from becoming onerous. Second, the Framers intended to require that any extensions in search and seizure doctrine pass through a warrant requirement.[40] This would limit the types of warrantless searches to those already permitted under the then-existing common law. Third, clear limits would be placed on the government's ability to obtain a warrant by requiring that certain conditions be satisfied before a magistrate issues the warrant.[41] The overall effect of this three-tiered approach was to encapsulate and limit the power of the government to invade the "right of the people to be secure in

37. The wording of the Fourth Amendment was altered from the form proposed by the Committee of Eleven and initially approved by the House of Representatives. Purportedly, Chairman Benson of the committee charged with preparing the final draft, changed the text to conform with an earlier version that he had proposed. The House had already soundly rejected Benson's proposed version. Without comment, and presumably unaware of the change, the House then passed the altered version. The Senate approved the altered version, and it was ratified by the States. This revised version became the Fourth Amendment. *See* United States v. Matlock, 415 U.S. 164, 180-83 (1974) (Douglas, J., dissenting) (setting out the Amendment's history); LASSON, *supra* note 33, at 97-103 (referencing 1 ANNALS OF CONGRESS (J. Gales ed., 1834) to show this sequence of events); *see also* Clark D. Cunningham, *A Linguistic Analysis of the Meanings of 'Search' in the Fourth Amendment: A Search for Common Sense*, 73 IOWA L. REV. 541, 541-53 (1988) (illustrating the linguistic analysis of the Fourth Amendment and its confusing history).

38. THE FEDERALIST No. 84, at 579 (Alexander Hamilton) (Jacob E. Cooke ed., 1961).

39. *See supra* note 4 and *infra* notes 43-44.

40. *See infra* notes 56-57 and accompanying text.

41. *See infra* notes 59-63 and accompanying text.

their persons, houses, papers, and effects"[42] from either a warrantless search *or* a search conducted with a warrant.

The first of these three tiers—that the Framers approved of the limited types of warrantless searches then permitted under the common law—is evidenced by the Framers' failure to explicitly respond in the Amendment to two realities. At the time the Framers created the Fourth Amendment, the common law permitted two types of warrantless searches and seizures: an official could conduct a search incident to arrest without a warrant,[43] and certain arrests could be made without a warrant.[44] Most of the original states generally adopted the English common law as the law of the state unless specifically preempted by state or federal law.[45] Yet in drafting the Amendment, the Framers did nothing to explicitly abrogate these common law warrantless searches.[46] Therefore, it is unlikely the Framers intended the Fourth Amendment's Warrant Clause to preempt the common law doctrine. The Framers would have expressly eliminated the common law doctrine permitting warrantless searches if it were their intent to do so. It would be inconsistent for the Framers to articulate explicitly the standards of a warrant requirement, and simultaneously abrogate the longstanding common law doctrine permitting warrantless searches through implication.[47]

Because of the system of checks and balances, the Framers arguably acquiesced to these limited types of warrantless searches. Abuse of these warrantless searches had been deterred historically through actions such as trespass and false imprisonment:[48] officials who conducted warrantless searches were generally not entitled to immunity unless vindicated by finding the felon or illegal goods;[49] there was no "good faith" exception for mistakes;[50] and recovery for trespass could be substantial because it was not limited to actual damages.[51] Presumably, the Framers felt that these safeguards provided an

---

42. U.S. CONST. amend. IV.

43. The first case challenging the ancient search doctrine in England was not until the late nineteenth century. Dillon v. O'Brien, 16 Cox C.C. 245 (Ex. D. 1887) (rejecting the challenge and affirming the doctrine's validity).

44. *See generally* LASSON, *supra* note 33 (discussing permissible warrantless arrests in colonial times); TAYLOR, *supra* note 33 (same). One could also be arrested without a warrant "upon hue and cry" when the officer was unable to find the felon. WILLIAM SHEPPARD, THE OFFICES OF CONSTABLES, ch. 8, § 2, no.4 (1650).

45. *See* Wilson v. Arkansas, 115 S. Ct. 1914, 1917 (1995) ("Most of the States that ratified the Fourth Amendment had enacted constitutional provisions or statutes generally incorporating English common law . . . ."); *see also* N.J. CONST. of 1776, § 22, *reprinted in* 5 FEDERAL AND STATE CONSTITUTIONS 2598 (Francis N. Thorpe ed., 1909); N.Y. CONST. of 1777, art. 35, *reprinted in* 5 FEDERAL AND STATE CONSTITUTIONS, *supra*, at 2635; ORDINANCES OF MAY 1776, ch. 5, § 6, *reprinted in* 9 STATUTES AT LARGE OF VIRGINIA 127 (W. Hening ed., 1821).

46. *See* U.S. CONST. amend. IV. In addition, none of the variations of the Fourth Amendment adopted in state constitutions expressly abrogated the common law warrantless search doctrine. *See* 3-5 FEDERAL AND STATE CONSTITUTIONS, *supra* note 45.

47. *See generally* TAYLOR, *supra* note 33, at 27-29 (providing alternative analyses supporting the argument that the Framers did not intend to prohibit the limited types of warrantless searches then permitted under the common law); Amar, *supra* note 34, at 1175-81 (same).

48. 2 FREDERICK POLLOCK & FREDERIC W. MAITLAND, THE HISTORY OF THE ENGLISH LAW 582-84 (2d ed. 1903).

49. *Id.*

50. *See* WILLIAM E. NELSON, AMERICANIZATION OF THE COMMON LAW 17 (1975); Akhil R. Amar, *Of Sovereignty and Federalism* 96 YALE L.J. 1425, 1486-87, 1506-07 (1987).

51. *See* Wilkes v. Halifax, 19 Howell St. Tr. 1382, 1401 (1769) (permitting substantial re-

ample deterrent against abuse of the limited types of searches permitted without a warrant. These warrantless searches had been permitted in the colonies, and for several hundred years in England, without creating significant problems for the individual or the public.[52] The Framers did not see a need to prohibit the limited types of warrantless searches then permitted under the common law because there were relatively few professional police in colonial times.[53]

The Framers were keenly aware, however, of the inherent dangers arising from a government with unbridled discretion to search and seize. In crafting the Fourth Amendment, the Framers intended to deter the virtually limitless searching which took place under general warrants and writs of assistance. The inequities which resulted from abuse of the general warrant and the writs of assistance are well documented[54] and were a major impetus in the occurrence of the American revolution.[55]

While these abusive searches were technically conducted with warrants, the general warrant and the writs of assistance did not limit government discretion. The Framers were concerned that unless the warrantless system was limited, it would lead to the type of abuse which occurred under general warrants and writs of assistance. This insight and anxiety led to the second and third tiers of the Fourth Amendment's Warrant Clause. While they acquiesced to the limited types of warrantless searches permitted under the common law, the Framers intended that a warrant requirement—one with teeth—be imposed upon any new type of search subsequently arising.

Under the second tier, a government agent would have to obtain a warrant from a neutral magistrate before conducting a search or seizure.[56] This requirement placed a check on unregulated government intrusion into individual liberty and privacy, regardless of the number of new types of searches arising or the increasing number of government officials engaged in searching activi-

---

covery from Earl (Lord) Halifax, Secretary of State and Lord of the King's Privy Council, and demonstrating the lack of immunity by even high ranking government officials); Wilkes v. Wood, 98 Eng. Rep. 489 (C.P. 1763).

52. *See* 2 POLLOCK & MAITLAND, *supra* note 48.

53. *See id.* "[T]here is no professional police force. The only persons specially bound to arrest malefactors are the sheriff, his bailiffs and servants and the bailiffs of those lords who have the higher regalities." *Id.* at 582.

54. *See, e.g.*, Wilkes v. Halifax, 19 Howell St. Tr. 1382, 1401 (1769); Entick v. Carrington, 19 Howell St. Tr. 1029 (1765); Wilkes v. Wood, 98 Eng. Rep. 489 (C.P. 1763); 2 LEGAL PAPERS OF JOHN ADAMS, *supra* note 32, at 106-47.

55. *See* 2 LEGAL PAPERS OF JOHN ADAMS, *supra* note 32, at 107 ("Then and there the child Independence was born."). The General Warrant was authorized during the reign of Charles II. Chief Justice Scroggs upheld the warrant's validity after its statutory authorization expired, but he was subsequently impeached by the House of Commons for having done so. The King v. Scroggs, 8 Cobbett St. Tr. 163, 192-93, 200 (1680); Entick v. Carrington, 19 Howell St. Tr. 1029, 1071-72 (1765). In addition, two types of statutory warrants, the Writ of Assistance and the Special Warrant (to search out seditious libel), were similar to general warrants in that they authorized uncontrolled government searches. Used in both England and the Colonies, their abuse is generally credited with creating the impetus for the Fourth Amendment. *See supra* note 33. These statutory warrants were consistently compared unfavorably to the common law stolen goods warrant for not containing the same quality of safeguards. *See supra* note 54 and *infra* text accompanying notes 59-61.

56. *See* U.S. CONST. amend. IV.

ties. As noted by the Supreme Court approximately two hundred years later, "The prominent place the warrant requirement is given in our decisions reflects the basic constitutional doctrine that individual freedoms will best be preserved through a separation of powers and division of functions among the different branches and levels of government."[57]

However, because the Framers recognized that the government could become abusive in a system where searches are conducted with warrants, the third tier placed limits on what the government was able to do with a warrant.[58] To prevent abuse of the warrant process, the Framers placed particular requirements in the Fourth Amendment which were modeled after the conditions required to obtain a common law stolen goods warrant. A common law stolen goods warrant required the victim of a theft to make an oath before a Justice of the Peace, demonstrating probable cause that the stolen goods would be found in a particular place.[59] The Justice would then issue a warrant authorizing the victim and a constable to search and seize the goods and bring the goods and the suspected felon back before the Justice for disposition.[60] Failure to find the goods left the oath-giver open to an action for damages.[61] Under the Fourth Amendment, a warrant requires specificity, oath, probable cause, and approval by a neutral and detached magistrate.[62] The magistrate limits oppressive government searches by refusing to issue a warrant if any of the requirements are not satisfied or if the intended search is unreasonable.[63] This requirement protects the individual from government abuse of warrant power similar to that which had been common under English rule.[64]

Consequently, in the second and third tiers the Framers sought to limit warrantless searches, and warrant searches, respectively. These tiers work together to prevent capricious searches in all situations where a warrant is required for a search. The historical evidence suggests that the warrant requirement was seen as a double-edged sword which would have to be carefully utilized in order to preclude causing the very harm it was designed to prevent. While the Framers endorsed an enhanced warrant requirement[65] as a means of controlling government discretion, they were also keenly aware that a toothless warrant requirement would lead to a more intrusive government.

Today, the Framers' original intent to limit government discretion to search and seize can best be satisfied through a strengthened warrant requirement. The current exceptions to the warrant requirement allow for a plethora

---

57. Arkansas v. Sanders, 442 U.S. 753, 759 (1979) (quoting United States v. United States District Court, 407 U.S. 297, 317 (1972)).

58. *See* U.S. CONST. amend. IV.

59. HALE, PLEAS OF THE CROWN, ch. 18, 149r-52 (published posthumously, 1609-76).

60. *Id.*

61. *Id.*

62. U.S. CONST. amend. IV.; Johnson v. United States, 333 U.S. 10, 14 (1948).

63. Winston v. Lee, 470 U.S. 753 (1985) (denying the government a search warrant, even though probable cause was satisfied, to surgically remove evidence, a bullet, from an individual, because the intended search was unreasonable).

64. *See supra* note 54 and accompanying text.

65. For a discussion of specific methods to strengthen the warrant process, see *infra* part III.B.

of warrantless searches other than those historically permitted under the common law. Requiring a government agent to obtain a warrant before conducting a search or seizure still allows the government to investigate, but only in a controlled fashion. Modern technology facilitates timely searches, without sacrificing the protection of a warrant.

B. *The Warrant Requirement Is Consistent with the Supreme Court's Fourth Amendment Precedents*[66]

Despite the willingness of some current Justices to dispense with the warrant requirement, the Supreme Court has underscored the importance of the warrant requirement for more than one hundred years. It is more consistent with Fourth Amendment jurisprudence to require that searches be conducted with warrants.[67] It would further the Supreme Court's guiding role if the Court were to eliminate or narrow some of the exceptions to the Fourth Amendment warrant requirement, and rearticulate an earnest commitment to the principle that government agents must first obtain a warrant before conducting a search or seizure.

Stare decisis requires that courts abide by decided cases and adhere to precedent.[68] Because stare decisis makes the law more predictable, individual citizens, the community, and government agents can more easily conduct themselves in accordance with the law. Such consistency and predictability are particularly important in criminal law where community safety, individual privacy, and individual liberty interests are at stake.

As previously suggested, the Framers of the Constitution created the Fourth Amendment to protect individuals from the arbitrary and capricious behavior of the government. "[T]he forefathers, after consulting the lessons of history, designed our Constitution to place obstacles in the way of a too permeating police surveillance, which they seemed to think was a greater danger to free people than the escape of some criminals from punishment."[69]

When the courts do not adhere to precedent, they fail to guide police officers and other government agents. Consequently, such agents are left to decide how to balance public safety against individual privacy interests and, in their zeal to protect the public, they may search individuals without reason. It is

---

66. The author gratefully acknowledges Shannon Hall for her research, suggestions, and contributions to this section.

67. The United States Supreme Court has repeatedly held that a search conducted without a warrant is unreasonable. *See, e.g.*, Katz v. United States, 389 U.S. 347 (1967). Furthermore, the Court has consistently held that unreasonable searches and seizures are forbidden by the Fourth Amendment. *See, e.g.*, Nathanson v. United States, 290 U.S. 41 (1933); United States v. Lefkowitz, 285 U.S. 452, 464 (1932). Consequently, except in narrow circumstances of absolute necessity, warrantless searches are presumptively unconstitutional. Chimel v. California, 395 U.S. 752, 768 (1969).

68. *See, e.g.*, Planned Parenthood v. Casey, 112 S. Ct 2791, 2808 (1992) ("[T]he very concept of the rule of law underlying our own Constitution requires such continuity over time that a respect for precedent is, by definition, indispensable."); Lewis F. Powell Jr., Stare Decisis *and Judicial Restraint*, 1991 J. SUP. CT. HIST. 13, 16.

69. United States v. Di Re, 332 U.S. 581, 595 (1948).

important, therefore, that the Supreme Court follow precedent and fulfill its guiding role.

Over the years, the Court has repeatedly emphasized the importance of the warrant requirement. In 1877, the Supreme Court held that a government agent must first obtain a warrant before searching mailed letters and packages.[70] The Court concluded that the warrant required to search or seize mail demands the same particularity and probable cause required to search or seize papers within one's house.[71] Significantly, the Court did not question the postulate that the government can search for such papers with a warrant in the home.

In the early 1900s, the Court emphasized that probable cause alone, without a warrant, is generally not enough to search one's home.[72] The Court held that the "[b]elief, however well founded, that an Article sought is concealed in a dwelling house, furnishes no justification for a search of that place without a warrant."[73] The Court emphasized that the judicial magistrate is essential in the warrant process. Notably, the Supreme Court also has held that the "informed and deliberate determinations of magistrates empowered to issue warrants . . . are to be preferred over the hurried action of officers and others who happen to make arrests."[74]

The Court continued to emphasize the necessity of magistrates and "adherence to judicial processes"[75] during the middle of the twentieth century. The purpose of interposing a magistrate between the police officer and the citizen was to ensure that a citizen's privacy and possessory interests were not overtaken by overzealous police officers. The Supreme Court eloquently expressed this thought in *Johnson v. United States*:[76]

> The point of the Fourth Amendment, which is often not grasped by zealous officers, is not that it denies law enforcement the support of the usual inferences which reasonable men draw from evidence. Its protection consists in requiring that those inferences be drawn by a neutral and detached magistrate instead of being judged by the officer engaged in the often competitive enterprise of ferreting out crime.[77]

In several decisions the Court held that the "essential purpose of the Fourth Amendment [is] to shield the citizen from unwarranted intrusions into [the citizen's] privacy."[78] For example, in *Jones v. United States*,[79] the Court found that a search conducted at night and with probable cause was unconstitutional because the warrant to search was limited to daytime hours. The Court has consistently held that probable cause without a warrant is generally not enough to search a home.[80] Noting the important role of the magistrate in the

---

70. *Ex Parte* Jackson, 96 U.S. 727 (1877).
71. *Id.* at 732.
72. Agnello v. United States, 269 U.S. 20, 33 (1925).
73. *Id.*
74. United States v. Lefkowitz, 285 U.S. 452, 464 (1932).
75. United States v. Jeffers, 342 U.S. 48, 51 (1951).
76. 333 U.S. 10 (1948).
77. *Johnson*, 333 U.S. at 13-14.
78. Jones v. United States, 357 U.S. 493, 498 (1958).
79. 357 U.S. 493 (1958).
80. *Jones*, 357 U.S. at 498. "Were federal officers free to search without a warrant merely

warrant process, the Court announced:

> In a doubtful case, when the officer does not have clearly convincing evidence of the immediate need to search, it is most important that resort be had to a warrant, so that the evidence in the possession of the police may be weighed by an independent judicial officer, whose decision, not that of the police, may govern whether liberty or privacy is to be invaded.[81]

In the 1960s and early 1970s, the Court took advantage of many opportunities to guide and lead, repeatedly holding that a warrant is generally required to search.[82] In *Rios v. United States*,[83] the Court held that a warrantless search could not be justified as a search incident to arrest because probable cause for arrest did not exist when the police officers approached the petitioner.[84] Consequently, the police could not search without a warrant. In *Stoner v. California*,[85] the Court ruled that a hotel guest is entitled to the same constitutional protection against unreasonable searches and seizures that the guest would have in his own home.[86] The Court concluded that if the search is conducted without a warrant, "[it] can survive constitutional inhibition only upon a showing that the surrounding facts brought it within one of the exceptions to the rule that a search must rest upon a search warrant."[87] The Court reasserted the constitutional significance of the magistrate's predetermination that probable cause is present in *Beck v. Ohio*.[88] Finding a warrantless arrest unconstitutional, the Court stated that "the far less reliable procedure [of] an after-the-event justification for the arrest or search [is] too likely to be subtly influenced by the familiar shortcomings of hindsight judgment."[89] In *Katz v. United States*,[90] the Court held that an individual has a reasonable expectation of privacy in a conversation from a public telephone and a warrant is required to listen to that conversation.[91] Without a warrant, such a search is unconstitutional even if government agents have probable cause to believe they will discover evidence of a crime and the officers use the least intrusive means to obtain the evidence.[92] Emphasizing the historical importance of the warrant requirement, the Court stated:

---

upon probable cause to believe that certain articles were within a home, the provisions of the Fourth Amendment would become empty phrases, and the protection it affords largely nullified." *Id.*

81. Jones v. United States, 362 U.S. 257, 270-71 (1960).

82. *See, e.g.*, Chapman v. United States, 365 U.S. 610 (1961) (holding that a landlord's consent was not enough to justify a warrantless search); *see also* Agnello v. United States, 269 U.S. 20, 32 (1925) ("[We have] always . . . assumed, that one's house cannot lawfully be searched without a search warrant . . . .").

83. 364 U.S. 253 (1960).

84. *Rios*, 364 U.S. at 261.

85. 376 U.S. 483 (1964).

86. *Stoner*, 376 U.S. at 490.

87. *Id.* at 486.

88. 379 U.S. 89 (1964).

89. *Beck*, 379 U.S. at 96.

90. 389 U.S. 347 (1967).

91. *Katz*, 389 U.S. at 353.

92. *Id.* at 356-57.

> The warrant requirement has been a valued part of our constitutional law for decades . . . . It is not an inconvenience to be somehow "weighed" against the claims of police efficiency. It is, or should be, an important working part of our machinery of government, operating as a matter of course to check the "well-intentioned but mistakenly overzealous executive officers" who are a part of any system of law enforcement.[93]

For more than one hundred years, the Court has emphasized the importance of the warrant requirement. Recently, however, it has been increasingly willing to dismiss the Warrant Clause and create additional exceptions to the warrant requirement. Even without a warrant, police are free to make a protective sweep in a home after an arrest,[94] search a foreign national's property located outside the United States,[95] search and seize curbside garbage,[96] search privately owned open fields,[97] and search some mobile homes.[98] Similarly, government agents without a warrant may search the entire passenger compartment of a vehicle, and all closed containers therein,[99] as well as open and search an arrestee's possessions.[100] Government agents may avoid the warrant requirement by obtaining the consent of a third-party to search,[101] or they may obtain an individual's consent and search without a warrant, regardless of whether the individual truly understands the right to refuse.[102] Furthermore, police who have not obtained a judicial warrant[103] may seize anything seen within "plain view,"[104] stop and frisk a citizen with only "reasonable suspicion,"[105] conduct administrative searches,[106] and conduct a search, or seize items, when any of a vast variety of exigent circumstances are present.[107]

---

93. Coolidge v. New Hampshire, 403 U.S. 443, 481 (1971).
94. Maryland v. Buie, 494 U.S. 325 (1990).
95. United States v. Verdugo-Urquidez, 494 U.S. 259 (1990).
96. California v. Greenwood, 486 U.S. 35 (1988).
97. United States v. Dunn, 480 U.S. 294 (1987).
98. California v. Carney, 471 U.S. 386 (1985) (permitting the warrantless search of a motor home when the motor home comes within an extended version of the automobile exception).
99. New York v. Belton, 453 U.S. 454 (1981) (extending the search incident to arrest doctrine).
100. South Dakota v. Opperman, 428 U.S. 364 (1976) (permitting the opening and search of an arrestee's items, pursuant to a standardized procedure, such as an inventory search).
101. United States v. Matlock, 415 U.S. 164 (1974).
102. Schneckloth v. Bustamonte, 412 U.S. 218 (1973).
103. *See infra* notes 183-87 and accompanying text (addressing additional exceptions to the warrant requirement under the Court's "special needs" analysis). *But see* Welsh v. Wisconsin, 466 U.S. 740 (1984) (rejecting an exception for the nighttime entry into a home to arrest for a civil traffic offense); Michigan v. Clifford, 464 U.S. 287 (1984) (declining to create a broad exception to cover searches for arson after a fire); Payton v. New York, 445 U.S. 573 (1980) (resisting an invitation to permit an automatic exception to the warrant requirement for the in-home arrest of all felons); Mincey v. Arizona, 437 U.S. 385 (1978) (refusing to create a broad exception to the warrant requirement for prolonged searches of murder scenes).
104. Coolidge v. New Hampshire, 403 U.S. 443, 464 (1971).
105. Terry v. Ohio, 392 U.S. 1 (1968).
106. Camara v. Municipal Court, 387 U.S. 523 (1967) (holding that warrants to conduct administrative inspections do not need to be based upon "probable cause" but instead can be based upon a "reasonable governmental interest" in conducting periodic, areawide inspections).
107. *See infra* part V.A.

The Supreme Court must recommit itself to requiring that law enforcement officers conduct searches with warrants. The Court satisfies stare decisis when it interprets the Fourth Amendment consistent with precedent.[108] Lower courts, prosecutors, the defense bar, and law enforcement personnel all benefit from such consistent interpretation.[109]

III. THE WARRANT REQUIREMENT OF THE FOURTH AMENDMENT MUST BE RE-EMBRACED AND STRENGTHENED

The Supreme Court must earnestly articulate its commitment to the principle that government agents must first obtain a warrant before conducting a search or seizure. Although considerable benefits can be obtained through the use of warrants, the process must also be enhanced so that the magistrate's assessment is meaningful. Unfortunately, the warrant process has at times operated in such a way that some of its theoretical advantages have been illusive.[110] The magistrate's determinations of probable cause and reasonableness must not merely be affirmative and spontaneous reflexes to a government agent's request for a warrant. The magistrate must be more than a "rubber stamp."[111] The warrant process must be enhanced to effectively establish a balance between the privacy and sanctity of the individual citizen (in places such as the home) and the discretion of the government to invade, search, and impound. This section first discusses several benefits that could result from compliance with the warrant requirement. It then suggests specific methods to strengthen the warrant process so that these benefits are actualized.

A. *Advantages Flowing from Magistrates and the Warrant Process*

The warrant requirement does not prevent legitimate government searches. Rather, it serves as a check on the discretion of the police and other government officials. It accomplishes this in two ways. First, the magistrate must confirm that the officer has probable cause to believe that the area to be searched contains—or that the item to be seized is—contraband or evidence of a crime.[112] Second, the magistrate must also evaluate the intended police conduct to determine if it complies with the reasonableness clause of the

---

108. Gore v. United States, 357 U.S. 386, 392 (1958) (recognizing that a long course of adjudication in the Supreme Court carries impressive authority); Smith v. Allwright, 321 U.S. 649, 665 (1944) (noting that continuity of decisions on constitutional questions is desirable).

109. *See generally* Donald L. Beci, *School Violence: Protecting Our Children and the Fourth Amendment*, 41 CATH. U. L. REV. 817, 836-37 (1992) (discussing the harm that results from the Court's lack of guidance when it succumbs to the temptation to issue politically popular, result-oriented decisions without regard to established Fourth Amendment precedent).

110. *See* Wayne R. LaFave, *Controlling Discretion by Administrative Regulations: The Use, Misuse, and Nonuse of Police Rules and Policies in Fourth Amendment Adjudication*, 89 MICH. L. REV. 442 (1990) (arguing that issuing magistrates should base their decisions upon objective criteria rather than simply deferring to the requesting agent's conclusions).

111. Aguilar v. Texas, 378 U.S. 108, 111 (1964) (stating that the probable cause decision must be made by a neutral and detached magistrate "[and that] the courts must . . . insist that the magistrate . . . perform his 'neutral and detached' function and not serve merely as a rubber stamp for the police").

112. Johnson v. United States, 333 U.S. 10 (1948).

Fourth Amendment: the desired search or seizure must be reasonable in light of all attending circumstances.[113]

The quintessential advantage of the warrant process is that a magistrate is in a better position than the criminal investigator to determine reasonableness and probable cause without bias,[114] haste,[115] or competitiveness.[116] The Supreme Court has invariably acknowledged this advantage.[117] A magistrate is assumed to have no bias or partiality between the individual citizen, whose liberty interest may be encroached upon, and the government agent, who seeks to uncover criminal activity.[118] In contrast, the agent has a personal role in the ongoing criminal investigation, which may generate intense emotion and some animosity.[119] An unbiased and impartial magistrate is customarily in a better position to determine reasonableness and probable cause than an officer who is immersed in what may unfold into an intense and emotional criminal investigation. There are at least five additional advantages.

The first advantage is that the warrant process benefits the innocent, law-abiding citizen because it provides a check on a government agent's actions *before* the agent conducts an unconstitutional search or seizure. The warrant requirement is preventive rather than remedial. If the magistrate determines that a proposed search or seizure is unreasonable or not supported by probable cause, the warrant is denied and the search or seizure never occurs.[120] The citizen's reasonable expectation of privacy has not been violated, and the citizen is not even aware of the government's intended breach. The warrant requirement balances individual privacy and liberty interests against intended law enforcement efforts. In the process, the warrant requirement protects the law-abiding citizen from overzealous government officials. In balancing individual privacy concerns and public safety, attention is focused on the privacy interests of the *innocent* individual. This is done without sacrificing reasonable law enforcement efforts.

In contrast, when a judge reviews a warrantless search or seizure *after the*

---

113. This safeguard allows the magistrate to deny a warrant for a search that is excessively intrusive, highly repugnant, or otherwise unreasonable, even if the officer has probable cause to believe the search will yield contraband or evidence. *See supra* note 63 and accompanying text.

114. United States v. Jeffers, 342 U.S. 48, 51 (1951) ("[T]he Amendment does not place an unduly oppressive weight on law enforcement officers but merely interposes an orderly procedure under the aegis of judicial impartiality that is necessary to attain the beneficent purposes intended.").

115. *Aguilar*, 378 U.S. at 110. "[T]he informed and deliberate determinations of magistrates empowered to issue warrants . . . are to be preferred . . . ." *Id.* (quoting United States v. Lefkowitz, 285 U.S. 452, 464 (1932)).

116. *Johnson*, 333 U.S. at 14 (preferring a "neutral and detached magistrate instead of . . . the officer engaged in the often competitive enterprise of ferreting out crime").

117. *See, e.g.*, Shadwick v. City of Tampa, 407 U.S. 345 (1972); Katz v. United States, 389 U.S. 347 (1967).

118. Wong Sun v. United States, 371 U.S. 471, 481-82 (1963).

119. *See* Cynthia L. Cordes & Thomas W. Dougherty, *A Review and an Integration of Research on Job Burnout*, 18 ACAD. MGMT. REV. 621 (1993).

120. *But see* United States v. Pace, 898 F.2d 1218, 1230-31 (7th Cir.) (permitting the police to circumvent the magistrate's denial and obtain a warrant from another magistrate based on the same facts), *cert. denied*, 497 U.S. 1030 (1990). While the Supreme Court has not yet addressed the permissibility of such "magistrate shopping," it is the author's position that the Court should prohibit or discourage such conduct. *See infra* notes 145-51 and accompanying text.

fact, during a suppression hearing, it is too late for preventive measures. Instead, the judge's only option is remedial: suppression can be granted, depriving the prosecution of the use of incriminating evidence and benefiting the guilty defendant.[121] It is this belief—that exclusion serves as a windfall to the guilty defendant—that has led to much of the public opposition to the exclusionary rule.[122] Exclusion attempts to balance individual privacy and liberty interests against intended law enforcement efforts; in the process the defendant gains a windfall.

The second advantage stems from the magistrate's opportunity to regularly participate in continuing education regarding developments in search and seizure law. Similar opportunities are typically unavailable to law enforcement officers. Continuing education is critical in this context, because, unlike many other areas of the law, courts are constantly reexamining and reinterpreting the Fourth Amendment.[123] The magistrate is in a better position to remain up to date on developments in Fourth Amendment jurisprudence; thus, the magistrate's determinations of probable cause and reasonableness are arguably more accurate than such assessments made by police officers.

Third, magistrates' determinations of probable cause and reasonableness are more consistent due to continuing education[124] and the fewer number of decision-makers involved. Each magistrate reviews several officers' conclusions of what constitutes probable cause and of what is reasonable.[125] Because the officers differ among themselves in their conclusions, each magistrate brings consistency to determinations of probable cause and reasonableness. Consequently, because fewer individuals are making such determinations, together with superior training, the sum of all magistrate determinations are more consistent than the sum of all determinations by law enforcement officers.

The fourth advantage is that the warrant process generates a contemporaneous and complete record for subsequent review. The warrant application states what basis the government agent had *before* the search for determining probable cause.[126] In addition, the magistrate's warrant outlines the permissible scope of the search.[127] These provide the courts with the actual limita-

---

121. While the exclusion of evidence after a warrantless search immediately benefits the guilty defendant, exclusion is also beneficial in that it often deters future unconstitutional searches and seizures by government agents. *See* Arizona v. Evans, 115 S. Ct. 1185, 1187 (1995) ("The exclusionary rule is a judicially created remedy designed to safeguard against future violations of Fourth Amendment rights through its deterrent effect.").

122. *See, e.g.*, Akhil R. Amar, *Are Truth and Justice the American Way? Hits, Runs, Trial Error: How Courts Let Legal Games Hide the Truth*, WASH. POST, Apr. 16, 1995, at C1; Jim McGee, *War on Crime Expands U.S. Prosecutors' Powers; Aggressive Tactics Put Fairness at Issue*, WASH. POST, Jan. 10, 1993, at A1.

123. California v. Acevedo, 500 U.S. 565, 582 (1991) (Scalia, J., concurring) (referring to "the . . . continuing . . . explosion in Fourth Amendment litigation").

124. *See infra* Part III.B, recommending additional magistrate training and continuing education.

125. *See* RICHARD VAN DUIZEND ET AL., NATIONAL CENTER FOR STATE COURTS, THE SEARCH WARRANT PROCESS: PRECONCEPTIONS, PERCEPTIONS, AND PRACTICES (1984).

126. *See, e.g.*, COLO. REV. STAT. § 16-3-303 (1986) (requiring that a statement of probable cause and written allegations of fact, supported by affidavit, be included within the application); N.C. GEN. STAT. § 15A-244 (1983) (similar requirements to those in Colorado).

127. The Fourth Amendment requires particularity as to the place to be searched and the

tions imposed at the outset of the search and the facts declared by the officer as the basis for the search. This record eliminates the courts' need to make a factual determination on the basis of conflicting and after-the-fact versions of what occurred or was intended. No such record exists when a search occurs without a warrant.

The fifth advantage of the warrant process is that it allows the officer to preserve evidence that would otherwise be lost in a suppression hearing if the officer conducted a warrantless search or seizure based on less than probable cause. This is because the magistrate alerts the officer that there is less than probable cause, giving the officer opportunity to gather more evidence. In contrast, if the officer conducted a warrantless search based on the initial evidence which did not constitute probable cause, the evidence would be excluded during a suppression hearing.[128]

B. *The Warrant Process Must Be Fortified So That the Magistrate's Determination of Probable Cause and Reasonableness Provides Its Intended Benefits*

The warrant process must be fortified if its benefits are to be genuine and not merely illusory. Three suggestions—one general and two specific—will be proposed for reinvigorating the warrant process so that the magistrate's check is meaningful.

First, a magistrate's entry-level job requirements, personality traits, initial training, and required continuing education must all be scrutinized. The goal of each requirement must be to increase the magistrate's accuracy and consistency, and to ensure that erroneous determinations of probable cause and reasonableness are minimized. While magistrate determinations are more consistent than those of law enforcement officers, there is still inconsistency among magistrates.[129] More stringent entry-level requirements, as well as additional magistrate training and continuing education, should result in more consistent determinations among magistrates. Such selection, training, and education requirements must also result in more accurate determinations, since consistency is only advantageous if the magistrate's determinations are accurate. When the warrant process results in determinations that are both more accurate and more consistent, fewer innocent citizens will have their privacy or possessory interests violated by unconstitutional searches and seizures. In addition to

---

persons or things to be seized. U.S. CONST. amend. IV. Each state has also explicitly provided instructions as to the information it deems necessary to meet the Fourth Amendment requirements. *See, e.g.*, COLO. REV. STAT. § 16-3-304 (1986) (requiring a designation sufficient to establish the location of the premises, vehicles, or persons to be searched and a description of the items constituting the object authorized to be seized); N.C. GEN. STAT. § 15A-246 (1983) (similar to requirements in Colorado).

128. This same advantage has been articulated when police seek arrest warrants:

> [An] incentive for police to obtain a[n] [arrest] warrant is that they may desire to present their evidence to a magistrate so as to be sure that they have probable cause. If probable cause is lacking, the police will then have an opportunity to gather more evidence rather than make an illegal arrest that would result in suppression of any evidence seized.

United States v. Watson, 423 U.S. 411, 455 n.22 (1975) (Marshall, J., dissenting).

129. *See supra* note 125 and accompanying text.

being well-educated, a magistrate must not lack the courage to deny warrants when appropriate. While this personality trait may be difficult to assess, personality profile tests,[130] selection interviews, and professional references can help determine if a magistrate candidate has the requisite confidence and fortitude to deny warrants that are either unreasonable or not supported by probable cause.

This first suggestion can be implemented by either the Supreme Court or the various legislative bodies. The Supreme Court can take advantage of its review power and take the lead in establishing rigorous uniform standards for magistrates. In an effort to increase consistency and accuracy among magistrates, the Court can elaborate on the professional requirements set out for magistrates in *Shadwick v. City of Tampa*.[131] *Shadwick* only imposes two requirements: first, the magistrate must be "neutral and detached"; and second, the magistrate "must be capable of determining whether probable cause exists for the requested arrest or search."[132] The Court should explain what selection, performance, and continuing education standards are necessary to satisfy this second *Shadwick* requirement.

As an alternative, Congress and the state legislatures can act independently, and establish more rigorous standards for magistrate selection, performance, and continuing education. Some states presently have rigorous standards.[133] On the other hand, without uniform and base-level criteria, some jurisdictions will continue to have lax standards for magistrates.[134]

Second, to enhance the warrant process and make the magistrate's assessment more accurate, the magistrate should be exposed to potential liability for flagrant assessment errors. This approach would punish the magistrate more severely than the public for an unconstitutional search. Currently, in contrast, when evidence is seized through an unconstitutional search, the court's limited means of redressing the injury is to exclude the evidence at trial.[135] Diminished public safety is an unintended consequence that results from the exclusion of incriminating evidence.[136] Consequently, the public, rather than the

---

130. Commonly utilized personality profile assessment tools include the Minnesota-Multiphasic Personality Inventory (MMPI), which appraises abnormal personality traits, and the Myers-Briggs Type Indicator (MBTI), which ascertains normal personality characteristics.

131. 407 U.S. 345 (1972).

132. *Shadwick*, 407 U.S. at 350.

133. *See, e.g.*, ALA. R. J. ADMIN., Rule 18 (forbidding a magistrate from issuing a search warrant unless licensed to practice law in Alabama.); ALASKA R. ADMIN., Rule 19.2(b)(5) ("[Deputy magistrates must] have received training from a training judge or training judge's designee, prior to appointment as a deputy magistrate, for each judicial duty which the appointee will be certified to perform."); COLO. REV. STAT. § 19-1-108 (1994) ("Every magistrate appointed pursuant to this section shall be licensed to practice law in Colorado; except that county judges who are not lawyers may be appointed to serve as magistrates . . . to hear detention and bond matters.").

134. *See, e.g.*, N.D. ADMIN. RULES, Rule 20 ("Minimum qualifications for magistrates shall include: (a) United States' Citizenship, (b) Physical residence in the county of appointment after appointment unless physical residence is waived by the appointing and confirming authorities.").

135. When an officer searches with a warrant, and the officer has an objective, good-faith belief that the warrant is valid, not even this remedy (i.e., exclusion) is available to the court. *See infra* notes 188-90 and accompanying text.

136. *See* Rakas v. Illinois, 439 U.S. 128, 137 (1978). "Each time the exclusionary rule is

magistrate, presently pays the price for the magistrate's blatant assessment errors. If liable for such errors, however, magistrates would be more careful in reviewing warrant applications. Arguably, the magistrate's extra care would result in greater accuracy. If magistrates are more accurate, there will be fewer unconstitutional searches necessitating exclusion. Hence, the public will be less burdened.

Magistrates, however, are presently not subject to liability for assessment errors. A state or local magistrate is granted absolute immunity from § 1983[137] claims when acting within the scope of the magistrate's official duties.[138] Likewise, a federal magistrate is granted absolute immunity[139] from claims arising under the judicially created counterpart to § 1983.[140] Consequently, a magistrate is presently immune from civil liability for issuing a warrant that violates an individual's Fourth Amendment rights.[141]

Instead, under this second suggestion, a magistrate would only be entitled to qualified immunity and would have greater motivation to accurately determine probable cause. The magistrate would only be immune from liability for an incorrect determination if a reasonably well trained magistrate in the same position could have made the same mistake and could have concluded that probable cause was demonstrated.[142] On the other hand, if the magistrate did not have an objectively reasonable belief that there was probable cause, then the victim of the unconstitutional search or seizure could seek compensatory damages from the magistrate.[143] Moreover, the victim would be entitled to

---

applied it exacts a substantial social cost for the vindication of Fourth Amendment rights. Relevant and reliable evidence is kept from the trier of fact and the search for truth at trial is deflected." *Id.*

137. 42 U.S.C. § 1983 (1988). This statute, which creates a Fourteenth Amendment damages action, provides:

> Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress.

Id.

138. Stump v. Sparkman, 435 U.S. 349, 356-57 (1978); Pierson v. Ray, 386 U.S. 547, 554 (1967). *See generally* SHELDON H. NAHMOD ET AL., CONSTITUTIONAL TORTS 233-41 (1995) (noting absolute immunity for judicial conduct, and discussing exceptions to the doctrine). In contrast, law enforcement officers are only granted qualified immunity from § 1983 claims when acting within the scope of their official duties. *See infra* note 156.

139. *See* Butz v. Economou, 438 U.S. 478, 508-09 (1978).

140. The judicially created counterpart to § 1983 imposes liability on federal agents. Bivens v. Six Unknown Named Agents, 403 U.S. 388, 397 (1971).

141. For a thorough discussion of immunity and intricate aspects of § 1983 actions, see 1 SHELDON H. NAHMOD, CIVIL RIGHTS AND CIVIL LIBERTIES LITIGATION: THE LAW OF SECTION 1983 (3d ed. 1991 & Supp. 1995).

142. *See* Anderson v. Creighton, 483 U.S. 635 (1987) (applying this standard in a *Bivens*-type action against an FBI agent who conducted a warrantless search of the plaintiff's home); Malley v. Briggs, 475 U.S. 335, 341 (1986) (applying this standard in a § 1983 action against a police officer who arrested the plaintiff with less than probable cause).

143. *See, e.g., Bivens*, 403 U.S. at 397 (approving recovery of money damages from federal agents who violated plaintiff's Fourth Amendment right); *see also* Carey v. Piphus, 435 U.S. 247, 254-57 (1978) (asserting that damages in a § 1983 action should parallel common law damages where tort interests parallel the constitutional interest protected).

punitive damages if the magistrate violated the individual's Fourth Amendment rights with deliberate indifference or reckless disregard.[144] Exposing magistrates to this potential liability would make the warrant process more meaningful. Additional methods, such as fines, suspensions, dismissal, and other professional sanctions, should also be considered for making magistrate assessments more accurate.

Third, to enhance the warrant process and discourage "magistrate shopping,"[145] government agents should have a reduced level of immunity from § 1983[146] civil liability (or its judicially recognized counterpart)[147] when they unearth a second magistrate who will issue a warrant after a first magistrate has already denied the application based on the same showing of probable cause. While the Supreme Court has not yet addressed this practice,[148] some lower courts permit officers to circumvent the warrant requirement in this way.[149] To discourage this practice, government agents should have a reduced level of immunity from civil liability when they engage in "magistrate shopping." Their immunity from liability should be reduced by creating a presumption that an officer who has already been denied a warrant by one magistrate—but then secures one from another magistrate based on the same showing of probable cause—is lacking an objectively reasonable belief as to the sufficiency of probable cause.

As one alternative to this third recommendation, the Supreme Court could candidly address and prohibit this practice. Unless the officer is presenting additional evidence to the magistrate to demonstrate probable cause,[150] there is no reasonable justification for permitting an officer to secure a warrant from a second magistrate after a first magistrate has already denied the application. Arguably, the Court's tolerance of this practice demeans the entire magistrate system.[151]

As another alternative, this third recommendation could be expanded and

---

144. *See* Smith v. Wade, 461 U.S. 30 (1983) (reformatory guard, named as a defendant in a § 1983 action, could be held liable for punitive damages).

145. *See* United States v. Czuprynski, 8 F.3d 1113, 1118 (6th Cir. 1993) (referring to the practice of seeking a warrant from a second magistrate after a first magistrate has denied the application based on the same showing of probable cause as "judge-shopping"); State v. Oakes, 598 A.2d 119, 122 (Vt. 1991) (referring to the practice of seeking a warrant from a second magistrate after a first magistrate has denied the application based on the same showing of probable cause as "magistrate shopping").

146. *See supra* note 137.

147. *See supra* note 140.

148. *See, e.g.*, United States v. Leon, 468 U.S. 897, 918 (1984) (making only oblique references to the undesirability of "magistrate shopping"); United States v. Pace, 898 F.2d 1218 (7th Cir.) (refusing to accept the opportunity to make a direct ruling on this issue), *cert. denied*, 497 U.S. 1030 (1990).

149. *See supra* note 120.

150. While the practice should be discouraged or prohibited when the officer presents the same evidence of probable cause to both magistrates, this article encourages the practice when the officer approaches the second magistrate only after the officer's additional investigation has developed additional evidence to demonstrate probable cause. For a discussion of the advantages that result when the officer has an opportunity to further investigate and develop probable cause, see *supra* note 128 and accompanying text.

151. *See generally* Charles L. Cantrell, *Search Warrants: A View of the Process*, 14 OKLA. CITY U. L. REV. 1 (1989) (discussing the repercussions of this practice).

made more far-reaching. Whenever an officer obtains a warrant after engaging in "magistrate shopping," the resulting search should be treated as if it had been conducted without the benefit of a warrant. None of the incentives normally available when a warrant is used would then be available to the officer, and all of the disincentives associated with a warrantless search would apply.

IV. INCENTIVES TO ENCOURAGE GOVERNMENT AGENTS TO USE THE WARRANT PROCESS AND DISINCENTIVES TO DISCOURAGE WARRANTLESS SEARCHES AND SEIZURES

Congress, state legislatures, and the courts should give government investigators incentives to use the warrant process and disincentives to engage in warrantless searches and seizures. While this article contends that, as a general rule, a government agent must obtain a warrant before conducting a search or seizure, some ambiguous situations will remain—particularly when vague exigent circumstances arise[152]—where an agent must be permitted to choose between a warrant or warrantless search. Five incentives and disincentives, to encourage the use of warrants, will be discussed.

As the first incentive, a government agent should be given greater immunity from civil liability for violating an individual's Fourth Amendment rights if the agent acts pursuant to a judicial warrant. An officer who conducts an unconstitutional search or seizure is subject to civil liability[153] under either § 1983[154] or its judicially recognized counterpart.[155] Presently, law enforcement officers are only entitled to qualified immunity from suits brought against them.[156] Consequently, a law enforcement agent can now be held civilly liable for an unconstitutional search or seizure even when acting pursuant to a search warrant. The magistrate's determination does not necessarily insulate the officer. The test is whether a reasonably well trained officer in the defendant officer's position would have known that probable cause was lacking.[157]

To achieve this first incentive, the agent's immunity from § 1983 civil liability and its judicially recognized counterpart should be increased by creating a presumption in the agent's favor when the agent acts pursuant to a search warrant. When the officer proceeds on the basis of a warrant that has been issued by a neutral and detached magistrate, the officer should be entitled to a presumption that the officer's belief regarding the sufficiency of probable

152. *See infra* part V.A.

153. In addition to liability under § 1983 and its judicially recognized *Bivens*-type counterpart, government agents who conduct unconstitutional searches or seizures may also be liable under state tort law, state statutes, or other federal statutes. While these additional areas of liability will not be expressly addressed, this article recommends that the incentive of increased immunity be made available in any civil action against an officer when the officer acts pursuant to a judicial warrant.

154. 42 U.S.C. § 1983 (1988).

155. *See* Butz v. Economou, 438 U.S. 473, 508-09 (1978).

156. *See* Harlow v. Fitzgerald, 457 U.S. 800, 807 (1982) ("For executive officials in general . . . our cases make plain that qualified immunity represents the norm [in a *Bivens*-type action].").

157. *See supra* note 142.

cause is objectively reasonable. While a plaintiff could offer rebuttal evidence, the defendant would have the benefit of the presumption.

As a second incentive for government agents to use warrants, the burden of production and persuasion should be placed on the defendant if a warrant has been obtained to show that a search or seizure is unconstitutional. While many states currently place these burdens on the defendant,[158] some states place the burden of production and persuasion on the government even when the officer conducts the search pursuant to a warrant.[159] As an incentive, this article instead recommends that these burdens uniformly be placed on the defendant whenever a warrant is used. On the other hand, if the officer conducts a warrantless search or seizure, the burden is now placed, and should remain, on the prosecution to prove that the warrantless search is constitutional.[160] To discourage warrantless activity, the state should have to prove that the search was reasonable, the search was based on probable cause, and one of the exceptions to the Warrant Clause justified the warrantless search.

A third inducement for government agents to use warrants involves limitations on the time available to the defendant to move for suppression. Presently, some states require a defendant to make a suppression motion prior to trial or lose the claim.[161] Other states allow a defendant to make a suppression motion during the trial.[162] This article recommends that the defendant should be required to either challenge the constitutionality of the seized evidence before trial or forfeit the right to the motion when an officer conducts the search with a warrant. This incentive would provide several benefits to the prosecution, including reducing the prosecutor's uncertainty regarding the witnesses to be called and the evidence to be adduced at trial. In addition, this incentive could provide the prosecutor with an opportunity to immediately appeal an adverse ruling. In contrast, if the officer conducts a warrantless search, the defendant should be permitted to challenge the search anytime prior to, or during, trial.

---

158. *See, e.g.*, People v. Hoskins, 461 N.E.2d 941, 942 (Ill.), *cert. denied*, 469 U.S. 840 (1984); State v. Milliorn, 794 S.W.2d 181, 184 (Mo. 1990).

159. *See, e.g.*, People v. Crow, 789 P.2d 1104 (Colo. 1990); State v. Slaughter, 315 S.E.2d 865 (Ga. 1984); Brooks v. State, 497 N.E.2d 210 (Ind. 1986); State v. Heald, 314 A.2d 820 (Me. 1973); Canning v. State, 226 So. 2d 747 (Miss. 1969). *See generally* Stephen A. Saltzburg, *Standards of Proof and Preliminary Questions of Fact*, 27 STAN. L. REV. 271 (1975) (discussing approaches to determining preliminary questions of fact).

160. *See* United States v. Matlock, 415 U.S. 164, 177 n.14 (1974).

161. *See* United States v. Sisca, 503 F.2d 1337 (2d Cir.), *cert. denied*, 419 U.S. 1008 (1974); State v. Neese, 616 P.2d 959 (Ariz. Ct. App. 1980); State v. Brogdon, 426 So. 2d 158 (La. 1983); State v. Baker, 409 A.2d 216 (Me. 1979); State v. Madsen, 414 N.W.2d 280 (Neb. 1987); State v. Neset, 462 N.W.2d 175 (N.D. 1990). *See generally* FED. R. CRIM. P. 12, 41 (requiring motions to suppress evidence be raised prior to trial).

162. *See* State v. Boose, 202 N.W.2d 368 (Iowa 1972); Shanks v. Commonwealth, 504 S.W.2d 709 (Ky. 1974); State v. Hicks, 488 N.W.2d 359 (Neb. 1992); State v. Ortega, 836 P.2d 639 (N.M. Ct. App. 1992); Whitnel v. State, 564 S.W.2d 373 (Tenn. Crim. App. 1978). Some jurisdictions predicate this right on meeting certain conditions. *See, e.g.*, N.C. GEN. STAT. § 15A-975(b), -976(b) (1994). The North Carolina statutes as interpreted by the North Carolina Supreme Court allow the defendant to make such a motion during trial when the prosecution seeks to adduce evidence from a warrantless search, but denies the defendant the right if the prosecution gives at least 20 working days notice before trial of the intent to introduce such seized evidence at trial. State v. Hill, 240 S.E.2d 794, 803 (N.C. 1978).

A fourth incentive to use warrants is to permit the prosecution to make an interlocutory appeal of all suppression rulings favorable to the defense whenever the suppressed evidence was acquired with a warrant. On the other hand, the corresponding disincentive to government agents that should result from not using warrants is that the prosecution should forfeit the right to an interlocutory appeal. As noted above, when a search is conducted pursuant to a warrant, the defendant should be required to raise relevant suppression motions prior to trial. If the court rules against the state, the state should then be permitted to make an interlocutory appeal. The trial could then be stayed until the issue is resolved. The state would then have the advantage, if the suppression order is overturned, of using the previously excluded evidence at trial. The availability to the prosecution of immediate appellate review encourages government use of warrants. In contrast, when a government agent does not use a warrant, the prosecution should lose the right to appeal suppression rulings favorable to the defense. As noted, when a warrantless search occurs, the defendant should be permitted to challenge the search anytime prior to, or during, trial. Moreover, if the court rules against the state, the state should not be permitted to make an immediate appeal. Consequently, the state would lose any advantage that would result from using the excluded evidence at trial. While some states presently deny the prosecution immediate appellate review from suppression rulings favorable to the defense,[163] this article recommends that the government uniformly be denied immediate review when the warrant process is not used.

As a fifth inducement for government agents to use warrants, the category of victims who have standing to challenge the constitutionality of the search should be broadened when no warrant is used. Over the years, the Supreme Court has narrowed the class of individuals who have standing to challenge the constitutionality of a search.[164] An individual who is legitimately on the premises searched no longer has automatic standing to challenge the search.[165] Additionally, an individual who is charged with criminal possession no longer has automatic standing simply because the individual legally possesses the item searched.[166] Presently, standing is only granted to an individual who has a legitimate expectation of privacy in the item searched.[167]

To encourage the use of warrants, only the present limited category of individuals recognized in *Rakas*[168] should continue to have standing to challenge a search or seizure conducted with a warrant. However, when the police

163. *See, e.g.*, State v. Parks, 415 So. 2d 704, 706 (Miss. 1982) (denying interlocutory appeal). *But see, e.g.*, State v. Perbix, 331 N.W.2d 14, 17 (N.D. 1983) (allowing interlocutory appeal).

164. United States v. Salvucci, 448 U.S. 83, 92 (1980) ("We simply decline to use possession of a seized good as a substitute for a factual finding that the owner of the good had a legitimate expectation of privacy in the area searched."); Rakas v. Illinois, 439 U.S. 128, 142 (1978) (rejecting automatic standing because it "creates too broad a gauge for measurement of Fourth Amendment rights").

165. *Rakas*, 439 U.S. at 142.

166. Rawlings v. Kentucky, 448 U.S. 98 (1980).

167. *Rakas*, 439 U.S. at 143.

168. *Id.*

choose not to use a warrant, the class of individuals permitted to challenge the search or seizure should be broadened. Logically, anyone against whom seized evidence will be used should have standing to challenge the constitutionality of the search or seizure. Standing could be granted to this broader class of individuals when government agents choose to act without warrants to discourage warrantless activity. By expanding the category of victims who have standing to challenge warrantless searches, prosecutors will be induced to persuade government agents to obtain warrants before searching, and thus reduce the number of potential suppression hearings at which they will have to defend.

V. THERE SHOULD BE FEWER EXCEPTIONS TO THE WARRANT REQUIREMENT AND NO ADDITIONAL EXCEPTIONS TO THE EXCLUSIONARY RULE

A. *Due to Technological Advances, the Exigent Circumstances Exception to the Warrant Requirement Should Be Narrowed, and Other Exceptions Should Be Studied, Narrowed, and Eliminated*

The Supreme Court should eliminate or narrow some of the exceptions to the warrant requirement and permit fewer warrantless searches and seizures because of the safeguards that warrants provide and the historical basis supporting their use. This is currently possible given advances in computer and telecommunications technology. Furthermore, future technological advances will enable the subsequent elimination or narrowing of additional exceptions to the warrant requirement.

Perhaps the exigent circumstances exception[169] is foremost among the exceptions affected by new technology. Under the exigent circumstances exception, an officer may conduct a search without a warrant if the officer has probable cause to believe that the person or item to be searched will be gone,[170] the evidence will be destroyed,[171] or someone will be put in danger[172] if the officer takes the time to obtain a warrant before searching. In addition to this freestanding exigent circumstances exception, most of the other exceptions to the warrant requirement were initially based on exigency.[173] Given the prior difficulty of obtaining a warrant and the attending exigent circumstances, the Supreme Court was compelled, in many situations, to sacrifice the vital safeguards provided by the warrant requirement.

Advances in electronic and telecommunications technology, however, have eliminated many of the temporal and geographic hurdles which previously

---

169. *See* Warden, Md. Penitentiary v. Hayden, 387 U.S. 294, 299 (1967) (explaining that exigent circumstances do not require a warrant).

170. United States v. MacDonald, 916 F.2d 766, 769 (2d Cir. 1990), *cert. denied*, 498 U.S. 1119 (1991).

171. United States v. Sangineto-Miranda, 859 F.2d 1501, 1512 (6th Cir. 1988); United States v. Socey, 846 F.2d 1439, 1445 (D.C. Cir.), *cert. denied*, 488 U.S. 858 (1988).

172. United States v. Perez, 440 F. Supp. 272, 287 (N.D. Ohio 1977), *aff'd*, 571 F.2d 584 (6th Cir.), *cert. denied*, 435 U.S. 998 (1978); People v. Sirhan, 497 P.2d 1121, 1140 (Cal. 1972), *cert. denied*, 410 U.S. 947 (1973).

173. *See supra* note 10; *see also infra* note 179 and accompanying text.

prolonged the time needed to obtain a warrant. Consequently, trial courts must give greater scrutiny when government agents invoke the exigent circumstances exception. A warrantless search[174] or seizure should only be permitted when the circumstances of the case are such that an officer would not even be able to seek an electronic warrant. While many courts have already refused to permit the exigent circumstances exception in situations where the officer could have obtained a telephone warrant,[175] courts must probe further. To justify a warrantless search on the basis of exigency, the government must show that the agent could not have obtained an electronic warrant in time to avoid the anticipated exigency.

Additional judicial scrutiny of exigent warrantless searches provides an added benefit. While government agents should not be permitted to deliberately create exigent circumstances to circumvent the warrant requirement, courts hesitate to scrutinize defense claims that the police intentionally manufactured an exigency to circumvent the warrant requirement.[176] In addition, the

---

174. Arguably, an exigency that justifies a warrantless seizure should not automatically justify a warrantless search. If the item (e.g., a suitcase) to be searched can be seized while the police obtain a warrant to search it, then the police should refrain from searching the seized item until the search warrant is obtained:

> In our view, when no exigency is shown to support the need for an immediate search, the Warrant Clause places the line at the point where the property to be searched comes under the exclusive dominion of police authority. Respondents were therefore entitled to the protection of the Warrant Clause with the evaluation of a neutral magistrate, before their privacy interests in the contents of the footlocker were invaded.

United States v. Chadwick, 433 U.S. 1, 15-16 (1977).

175. *See, e.g.*, United States v. Ford, 56 F.3d 265, 266 (D.C. Cir. 1995) ("They could have secured the bedroom and telephoned a magistrate for a search warrant . . . ."); United States v. Patino, 830 F.2d 1413, 1416-17 (7th Cir. 1987) (holding no exigency existed because a telephone warrant could have been obtained in the 30 minute period), *cert. denied*, 490 U.S. 1069 (1989); United States v. McEachin, 670 F.2d 1139, 1146 (D.C. Cir. 1981) ("[C]ourts must also consider the amount of time necessary to obtain a warrant by telephone in determining whether exigent circumstances exist."); United States v. Baker, 520 F. Supp. 1080, 1083 (S.D. Iowa 1981) (explaining that one hour and fifteen minutes was "abundant" time to obtain a telephone warrant, therefore no exigency existed). *But see, e.g.*, United States v. Tarazon, 989 F.2d 1045, 1050 (9th Cir.) (permitting a warrantless search after concluding that 30 minutes was not enough time to obtain a telephone warrant), *cert. denied*, 114 S. Ct. 155 (1993); United States v. Cuaron, 700 F.2d 582, 589-90 (10th Cir. 1983) (holding that 20 to 30 minutes was not enough time to obtain a telephone warrant).

This article does not encourage the use of telephone warrants. The application for, and issuance of, a telephone warrant lacks the safeguards which are present when either a computer modem or facsimile is used. While this procedure frees the officer of the temporal and geographic hurdles of submitting a warrant application, it does not have the advantage of providing a contemporaneous and complete record of the warrant application. The telephonic application can be recorded by the magistrate, but the risk is present that the recording will not be accurately transcribed. *See, e.g.*, State v. Cook, 498 N.W.2d 17 (Minn. 1993) (noting that the magistrate issued a search warrant on the basis of a telephone application which was not recorded, and that neither the officer nor the magistrate made notes of the conversation). Additionally, unless the officer proceeds on the basis of the magistrate's oral authorization, the officer must still use valuable time to obtain the issued warrant. Even if the officer is permitted to proceed on the basis of an oral warrant, applications made by telephone are slower than those submitted by facsimile or modem. With a telephone warrant, the requesting officer must completely read the application over the telephone before the magistrate's assessment can begin.

176. *See, e.g.*, United States v. Munoz-Guerra, 788 F.2d 295, 298 (5th Cir. 1986); United States v. Thompson, 700 F.2d 944, 950-51 (5th Cir. 1983); United States v. Houle, 603 F.2d 1297, 1300 (8th Cir. 1979); United States v. Scheffer, 463 F.2d 567, 575 (5th Cir.), *cert. denied sub nom.* 409 U.S. 984 (1972).

Supreme Court has not explicitly prohibited the practice. Until the Court does so, this troublesome practice would be diminished if the exception only applied when the circumstances of the case were such that an officer was not able to seek an electronic warrant. Because computer and facsimile warrants eliminate many of the temporal and geographic hurdles to obtaining a warrant, it becomes more difficult for criminal investigators to intentionally create the type of exigent circumstances that would permit them to proceed without a warrant.

The exigent circumstances exception is not the sole existing exception which could presently be narrowed due to technological advances. The Supreme Court should use its review power to thoroughly consider all other exceptions and determine which should be narrowed or eliminated in light of advances in computer and telecommunications technology. The automobile exception, and exceptions arising under the Court's "special needs" analysis,[177] are among the exceptions the Court should review.

The automobile exception allows a government agent to search an automobile without a warrant as long as the agent has probable cause to believe that the vehicle contains evidence relating to criminal activity.[178] This interpretation of the automobile exception deletes the warrant requirement, bypasses the magistrate, and allows a government agent to search a vehicle based on the agent's own determination of probable cause. The agent can search the vehicle even where there is no danger that the automobile will be moved. While the automobile exception was originally permitted because of the inherent mobility of—and encompassing exigency surrounding—the automobile,[179] the exception is now based on the reasoning that one has a reduced expectation of privacy in the automobile.[180] Thus, the police may conduct a warrantless search of a vehicle even if it is incapable of being moved.[181]

Arguably, one's expectation of privacy in the automobile is as great as, or greater than, it is in many other items of personal property. Given the mobility of American society, the percentage of the population engaged in commuting, and the amount of time people spend in automobiles, it seems unrealistic to conclude that an individual's automobile should be subject to a reduced expectation of privacy. Indeed, one Justice's comment can be interpreted as suggesting that in order to circumvent constitutional requirements, the Court has at times insincerely concluded that one has a lesser, or no, expectation of privacy: "Our intricate body of law regarding 'reasonable expectation of privacy' has been developed largely as a means of creating these exceptions, enabling a search to be denominated not a Fourth Amendment 'search' and therefore not subject to the general warrant requirement."[182]

The Court should not permit the warrantless search of an automobile

---

177. *See infra* notes 183-87 and accompanying text.

178. Carroll v. United States, 267 U.S. 132, 149 (1925).

179. *Id.* at 146.

180. California v. Carney, 471 U.S. 386, 392 (1985).

181. Chambers v. Maroney, 399 U.S. 42, 52 n.10 (1970) (permitting the warrantless search of an automobile after the owner had been arrested and the vehicle taken to the police station).

182. California v. Acevedo, 500 U.S. 565, 636 (1991) (Scalia, J., concurring).

unless it can be justified on the basis of a *true* exigency rather than a theoretical reduced expectation of privacy. Perhaps the balance between the government's investigative powers and individual privacy and liberty interests would be better maintained if the automobile exception as it now exists were eliminated. Instead, taking advantage of up-to-date computer and telecommunications technology, the preferred method of searching an automobile would be for the police to comply with the warrant requirement. A warrantless automobile search would then be unconstitutional unless it satisfied the stricter exigent circumstances exception proposed above. There would be no separate and independent automobile exception.

The Court is also increasingly creating exceptions to the warrant requirement through its "special needs" analysis.[183] The Court applies this analysis when it concludes that government agents have "special needs" beyond criminal law enforcement. Under this analysis, the Court has not only suspended the warrant requirement, but it has increasingly been willing to dispense with one or both of the other Fourth Amendment threshold requirements of probable cause and individualized suspicion.[184] Recently, the Court used this "special needs" analysis to permit public school officials to test student athletes for drug usage without a warrant, without probable cause, and without any individualized suspicion.[185]

While a useful analysis of each "special needs" exception is beyond the scope of this article, the Court must consider these exceptions to determine which can be narrowed or eliminated in light of advances in computer and telecommunications technology. Many of these "special needs" exceptions seem to be created out of desperation rather than concern for Fourth Amendment doctrine. While they are permitted because of the government's interest in something other than criminal law enforcement, the Supreme Court has not hesitated to permit the government to use the fruits of the search to convict the search victim of a crime.[186] Ultimately, and regrettably, the "special needs" exceptions may permanently realign traditional Fourth Amendment

183. *See, e.g.*, Skinner v. Railway Labor Executives' Ass'n, 489 U.S. 602, 620 (1989) (permitting suspicionless and warrantless urine testing of employees); O'Connor v. Ortega, 480 U.S. 709, 720-25 (1987) (allowing public employers to conduct warrantless searches of employees' desks and offices); New Jersey v. T.L.O., 469 U.S. 325, 340 (1985) (allowing the warrantless search of a child's possessions within school on the basis of reasonable suspicion); United States v. Martinez-Fuerte, 428 U.S. 543, 566 (1976) (permitting the temporary suspicionless seizure of motorists, without a warrant, at permanent checkpoints removed from the border); Almeida-Sanchez v. United States, 413 U.S. 266 (1973) (allowing warrantless and suspicionless border searches).

184. *See, e.g.*, Michigan Dep't of State Police v. Sitz, 496 U.S. 444, 454 (1990) (holding that sobriety checkpoints are constitutional without probable cause, individualized suspicion, or a warrant); National Treasury Employees Union v. Von Raab, 489 U.S. 656, 666-67 (1989) (allowing warrantless and suspicionless drug testing).

185. Vernonia Sch. Dist. 47J v. Acton, 115 S. Ct. 2386 (1995).

186. *Skinner*, 489 U.S. at 650-52 (Marshall, J., dissenting) (noting that a government agency conducting suspicionless and warrantless searches of its employees "appear[s] to invite criminal prosecutors to obtain the blood and urine samples drawn by the [agency] and use them as the basis of criminal investigations and trials" against its employees, notwithstanding that the government is only permitted to draw these samples because it claims to be conducting these searches on the basis of a special need other than law enforcement).

interests with minimal regard for the individual.[187]

B. *A New "Good Faith" Exception to the Exclusionary Rule Eliminates a Crucial Check on the Unbridled Discretion of Government Agents, and Should Not Be Created*

Under existing law, evidence obtained by government agents through a search or seizure conducted in the preferred manner—with a warrant—is already admissible in court against a criminal defendant.[188] The present *Leon* "good faith" exception permits the use of evidence against a criminal defendant in either state or federal court, even if it is obtained pursuant to a constitutionally defective warrant.[189] The existing "good faith" exception permits use of the evidence as long as the officer has an objective, good-faith belief that the warrant is valid, the officer acts within the scope of the warrant, and the issuing magistrate is neutral and detached.[190]

Notwithstanding the existing "good faith" exception to the exclusionary rule, however, many commentators have been anticipating an additional "good faith" exception—one that also permits the use of unconstitutionally seized evidence when an officer elects not to use the warrant process.[191] One example of such an exception has been advanced in Congress as part of the Republican party's "Contract with America."[192] The Exclusionary Rule Reform Act of 1995,[193] if enacted and upheld by the Supreme Court,[194] would permit

---

187. *See generally* Andrea Lewis, Comment, *Drug Testing: Can Privacy Interests Be Protected Under the "Special Needs" Doctrine?*, 56 BROOK. L. REV. 1013, 1033 (1990) (criticizing the "special needs" doctrine for essentially making balancing the norm rather than the exception).

188. United States v. Leon, 468 U.S. 897, 919 (1984).

189. *Id.*

190. *Id.* at 919 n.20, 920, 923.

191. *See,* Ronald J. Bacigal, *An Alternative Approach to the Good Faith Controversy*, 37 MERCER L. REV. 957, 976 (1986) ("The flexibility inherent in a totality of the circumstances test allows the Court to attach some unspecified weight to police motivation, instead of being forced to *Leon's* all-or-nothing decision in good faith."); Craig M. Bradley, *The "Good Faith Exception" Cases: Reasonable Exercises in Futility*, 60 IND. L.J. 287, 303 (1985) (noting that "the primary focus of attention should be on clarifying the rules rather than on making them increasingly unclear by focusing attention on penalties and exceptions"); Elizabeth P. Marsh, *On Rollercoasters, Submarines, and Judicial Shipwrecks: Acoustic Separation and the Good Faith Exception to the Fourth Amendment Exclusionary Rule*, 1989 U. ILL. L. REV. 941, 1016 ("A good faith exception similar to the mistake defenses in criminal law would restore partially the balance between the conduct rule and the decisional rule.").

192. The "Contract with America," as explained by Congressman Newt Gingrich (R-Ga.), Speaker of the House, is "a planning model [setting forth the Party's] vision, strategies, projects and tactics." Newt Gingrich, 1995 Summer Meeting, Republican National Committee, Phila., Pa. (July 14, 1995).

193. Introduced on January 25, 1995, the Exclusionary Rule Reform Act of 1995 requires:

> Evidence which is obtained as a result of a search or seizure shall not be excluded . . . on the ground that the search or seizure was in violation of the Fourth Amendment . . . if the search or seizure was carried out in circumstances justifying an objectively reasonable belief that it was in conformity with the Fourth Amendment. The fact that evidence was obtained pursuant to and within the scope of a warrant constitutes prima facie evidence of the existence of such circumstances.

Exclusionary Rule Reform Act of 1995, H.R. REP. NO. 104-17, 104th Cong., 1st Sess. 13 (1995).

194. *See* Baker v. Carr, 369 U.S. 186, 211 (1962) (emphasizing that the Supreme Court is the "ultimate interpreter of the Constitution"); Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177

prosecutors to use unconstitutionally seized evidence in federal court, even if no warrant was used, as long as the officer had an objectively reasonable belief that the search or seizure was constitutional.

An additional "good faith" exception is not necessary when the warrant process is followed and, while enactment of a new exception may result in political gain to its sponsors,[195] such an exception is likely to produce a multitude of unintended new harms. Perhaps most insufferable among these harms is that the new exception would abolish any significant check—either before or after—on the uninhibited discretion of government agents when they search and seize evidence. This check would be absent regardless of how reasonable a citizen's expectation of privacy in the area searched or the item seized. Presently, in contrast, there is a check on the officer's actions either prior to the search or afterwards: if the search is conducted with a warrant, a magistrate screens the officer's actions in advance;[196]if the search is conducted without a warrant, a judge reviews the officer's actions afterwards during a suppression hearing.[197] Under an additional "good faith" exception, all meaningful review would be abolished. Unlike the existing *Leon* "good faith" exception, the proposed exception abolishes the need for *prior* review by a magistrate, and because it essentially discontinues the suppression of unconstitutional evidence, the proposed exception also eliminates any meaningful *subsequent* judicial review.

Regrettably, an additional "good faith" exception to the exclusionary rule—one that arises when an officer elects not to use the warrant process—confers upon government agents virtually unbridled discretion to intrude, search, and seize evidence. In contrast, the warrant process and present "good faith" exception more fittingly balance and satisfy relevant Fourth Amendment liberty, privacy, and security interests. When government agents follow the warrant requirement, a citizen's liberty and privacy interests can be protected *and* effective law enforcement measures can be secured. The magistrate will customarily serve as a check on government discretion and—when the magistrate errs—evidence seized unconstitutionally, but in good faith, will

---

(1803) ("It is emphatically the province and duty of the judicial department to say what the law is."); *see also* Miller v. Johnson, 115 S. Ct. 2475, 2491 (1995) ("Were we to accept the Justice Department's objection . . . we would be surrendering to the Executive Branch our role in enforcing the constitutional limits on race-based official action. We may not do so.").

195. *See Congress' Get Tough Act Is a Real 'Crime'*, USA TODAY, Oct. 3, 1990, at A12 ("Like its predecessors . . . the 1990 crime bill . . . won't do much to protect us from crime. At best, it will only help its perpetrators get re-elected."); Debra J. Saunders, *Crime: What Congress Thinks of You*, S.F. CHRON., Apr. 13, 1994, at A23 ("President Clinton put the heat on Congress to pass a version of the Senate $22 billion omnibus crime bill, and quickly . . . . Clinton won't blow this opportunity to . . . look effective and curry favor with a crime-wary electorate.").

196. *See supra* notes 112-13 and accompanying text.

197. A defendant may also be entitled to both forms of review: even when a magistrate has reviewed the search warrant request in advance, a defendant can obtain subsequent judicial review at a suppression hearing. However, in this situation the judge does not make a de novo determination of probable cause but merely determines whether there was a substantial basis for the magistrate to find probable cause, and the judge gives great discretion to the magistrate's initial determination. Illinois v. Gates, 462 U.S. 213, 236 (1983). Even if the magistrate incorrectly issues a constitutionally defective warrant, the judge will not suppress the seized evidence if the officer acted in objective, good-faith reliance upon the warrant. *See supra* notes 188-90.

be used in court against a criminal defendant. Use of the warrant process, together with the existing *Leon* "good faith" exception, eliminates the need for either Congress or the courts to create a new "good faith" exception to the exclusionary rule.

CONCLUSION

Today's advanced computer, facsimile, and cellular technology permits the Supreme Court to reaffirm a meaningful commitment to the warrant requirement. Due to the availability of portable and lightweight cellular facsimile machines, the ability to transmit electronic documents directly between cellular computer modems, and the continual miniaturization of computer hardware, an officer can now quickly—and without leaving the investigation scene—obtain a warrant. The officer can electronically transmit a written but wireless warrant application and affidavit to the magistrate. The magistrate can then transmit the approved warrant back to the officer in the same fashion. Because investigators can now quickly obtain a warrant without leaving the area of investigation, the Court has the ability to respond to exigent circumstances *and* declare a renewed commitment to the warrant requirement.

The warrant requirement is consistent with the Framers' original intent in crafting the Fourth Amendment. The Framers endorsed a three-tiered approach to deterring capricious searches and seizures. First, they agreed to permit some types of warrantless searches. They were comfortable with these warrantless searches because of their belief that existing common law remedies would continue to prevent such warrantless searches from becoming threatening. Second, the Framers desired to prohibit any new types of search unless they were conducted pursuant to a warrant. Third, to prevent the new warrant requirement from becoming meaningless, the Framers intended that it be demanding enough to deter capricious government searches. By limiting the circumstances under which a warrant could be issued, the Framers sought to protect citizens from the type of warrant abuse similar to that recently suffered through the use of general warrants and writs of assistance under English rule.

The warrant requirement is also harmonious with over one hundred years of Supreme Court precedent. Recently, however, the Court has displayed an increased willingness to ignore the Warrant Clause and focus exclusively on the reasonableness clause through both its traditional analysis and the Court's "special needs" analysis. This has resulted in an increase in the creation of new exceptions to the warrant requirement. This trend must cease, and the Court must re-embrace the warrant requirement.

While the warrant requirement should be embraced because it is compatible with the Framers' original intent and over one hundred years of Supreme Court precedent, the requirement should also be championed because it produces several advantages. Its quintessential advantage is that it allows threshold decisions regarding the intrusion into a citizen's liberty and privacy to be made in an orderly, deliberate, and impartial manner. Additional advantages of the warrant process include the following: rather than award the guilty defendant a windfall, the warrant process protects the innocent, law-abiding citizen;

magistrate determinations of reasonableness and probable cause are more accurate, since the magistrate has greater opportunity to stay abreast of continuing developments regarding search and seizure law; due to continuing magistrate education and because fewer decision-makers are involved, a magistrate's determinations of probable cause and reasonableness are more consistent; it eliminates the need for courts to make uncertain factual determinations during subsequent review because the warrant process generates a contemporaneous and complete record of the government's basis for searching and of the scope of search initially authorized; and the warrant process allows the officer to preserve evidence that would otherwise be excluded due to a premature search, since the officer can gather more facts and strengthen the showing of probable cause if a magistrate has denied the officer's initial request.

The warrant process must also be improved to ensure that the magistrate's review provides a genuine check on the government's unrestrained discretion to search and seize evidence. The assessment must be meaningful, and not merely the spontaneous and routine approval of a police officer's application for a warrant. First, the Supreme Court must define what is constitutionally required—professionally and personally—for one to become and remain a magistrate. The Court must be more rigorous than it was in *Shadwick*[198] in articulating the entry-level, initial training, and continuing education requirements for a magistrate. Each requirement must increase the accuracy and consistency of the magistrate's assessment. If the Court is unwilling to establish rigorous uniform standards for magistrates, Congress and the state legislatures should establish the needed standards.

A second suggestion for enhancing the warrant process is to make a magistrate liable for flagrant assessment errors. A magistrate should no longer be absolutely immune from § 1983 claims or *Bivens*-type[199] claims. Instead, a magistrate should only be entitled to qualified immunity. In order to minimize potential liability, magistrates will then be more accurate in their determinations of reasonableness and probable cause. Third, to reinforce the warrant process, government agents must have a reduced level of immunity from civil liability when they seek and find a second magistrate who will issue a warrant after a first magistrate has already denied the application based on the same showing of probable cause. This practice of "magistrate shopping" mocks the warrant requirement.

While this article has sought to demonstrate why the warrant requirement must be the norm rather than the exception, some uncertain situations will remain where an officer must be allowed to choose between using a warrant or conducting a warrantless search. To encourage government agents to use the warrant process when these ambiguous situations arise, Congress, state legislatures, and the courts must implement the following incentives and disincentives: agents must be given greater immunity from civil liability when they conduct a search pursuant to a judicial warrant; the burden must be placed on the defendant to show that a search or seizure was unconstitutional

198. Shadwick v. City of Tampa, 407 U.S. 345 (1972).
199. Bivens v. Six Unknown Named Agents, 403 U.S. 388, 397 (1971).

when the officer conducts the search pursuant to a warrant; when a warrant is used, the defendant must be deemed to forfeit the right to a suppression hearing unless the defendant challenges the constitutionality of the seized evidence *prior* to the commencement of trial; when a trial court suppresses evidence seized pursuant to a warrant, the trial must be stayed and the prosecution given an opportunity for immediate appellate review, thereby giving the government an opportunity to use the excluded evidence at trial; and, when a government agent conducts a warrantless search, the class of victims who have standing to challenge the constitutionality of the search must be expanded.

In addition to articulating a new commitment to the warrant requirement, the Supreme Court must eliminate or narrow some of its previously created exceptions that are no longer necessary due to current technology. Foremost among these is the exigent circumstances exception. This exception must be narrowed, since today's advanced technology eliminates much of the time and many of the geographic hurdles which previously delayed obtaining a warrant. The exigent circumstances exception should be modified so that it only permits a warrantless search if an officer is unable to obtain a facsimile or computer warrant via cellular modem before searching. A second exception, the automobile exception, should be eliminated entirely. The Court should only permit the search of an automobile without a warrant if the stricter exigent circumstances test has been satisfied. The exigency must be such that the officer does not even have the time to obtain an electronic warrant prior to searching the vehicle. In addition to these two exceptions, the Court should diligently use its review process to determine which additional exceptions—arising under either the Court's traditional analysis or its "special needs" analysis—should be narrowed or eliminated due to advances in telecommunications technology.

While existing exceptions to the warrant requirement should be narrowed or eliminated, no further changes should be made to the exclusionary rule. Neither Congress nor the courts should create a new "good faith" exception to the rule. A new exception would eliminate a crucial check on the uncontrolled discretion of government agents. Moreover, a new exception serves no purpose when the warrant process is used since evidence obtained by government agents with a warrant is already admissible in court under existing law, even if the warrant is constitutionally defective.

The Court no longer has to choose between the warrant requirement and warrantless searches because of advances in telecommunications technology. Today's technology promotes a superior balance between the government's need to swiftly investigate during exigent circumstances, and an individual's privacy and liberty interests. Due to today's advanced telecommunications technology, the Supreme Court has the opportunity, without sacrificing public safety, to reclaim and preserve the Fourth Amendment's warrant requirement.

ORIGINS OF A FLAT TAX

STEVEN A. BANK*

The push toward radical reform of our federal system of graduated income tax rates hit the political scene like a sonic boom during 1995. No less than eight proposals were circulated or formally submitted by members of Congress, including plans by Senators Richard Lugar (R-Ind.) and Arlen Specter (R-Pa.), which were made the centerpieces of their respective campaigns for the Republican nomination in the 1996 presidential elections.[1] Furthermore, presidential candidates such as former Tennessee Governor Lamar Alexander,[2] political commentator Pat Buchanan,[3] Senator Bob Dole (R-Kan.),[4]

---

* Associate, Hughes & Luce, L.L.P., Dallas, Texas. B.A., University of Pennsylvania, 1991; J.D., University of Chicago, 1994. This article was written in part while the author was a law clerk for the Honorable Jesse E. Eschbach of the United States Court of Appeals for the Seventh Circuit. The author wishes to express thanks to Michael McConnell and Larry Lessig for their encouragement and comments. The views discussed herein do not necessarily represent the views of Hughes & Luce or its clients.

1. Tax reform plans already introduced in Congress include the following: The Freedom and Fairness Restoration Act of 1995, H.R. 2060, 104th Cong., 1st Sess. (1995) (submitted by Rep. Richard Armey (R-Tex.) on July 19, 1995) and its companion S. 1050, 104th Cong., 1st Sess. (1995) (submitted by Richard Shelby (R-Ala.) on July 19, 1995); H.R. 1780, 104th Cong., 1st Sess. (1995) (submitted by Mark Souder (R-Ind.) on June 7, 1995) and its companion S. 488, 104th Cong., 1st Sess. (1995) (submitted by Sen. Arlen Specter (R-Pa.) on Mar. 2, 1995); Crane Tithe Tax Act of 1995, H.R. 214, 104th Cong., 1st Sess. (1995) (submitted by Rep. Philip Crane (R-Ill.) on Jan. 4, 1995) and its companion the Flat Tax Act of 1993, S. 188, 103d Cong., 1st Sess. (1993) (submitted by Sen. Jesse Helms (R-N.C.) on Jan. 26, 1993); USA Tax Act of 1995, S. 722, 104th Cong., 1st Sess. (1995) (submitted by Sen. Sam Nunn (D-Ga.) on Apr. 25, 1995). *See* JOINT COMMITTEE ON TAXATION, 104TH CONG., 1ST SESS., DESCRIPTION AND ANALYSIS OF PROPOSALS TO REPLACE THE FEDERAL INCOME TAX (Joint Comm. Print 1995); JOINT COMMITTEE ON TAXATION, *Description and Analysis of Proposals to Replace the Federal Income Tax*, 82 Stand. Fed. Tax Rep. (CCH) No. 29, at 30-38 (June 15, 1995).

Plans that have been announced but not yet introduced include a "flat" tax proposal by House Democratic Leader Richard Gephardt (D-Mo.), in which the majority of the country would pay a flat tax while the richest would pay graduated rates. *See* Lucinda Harper, *Gephardt Outlines Tax-Reform Plan Cutting Deductibles*, WALL ST. J., July 7, 1995, at A2. Other announced plans include various sales tax proposals by Senator Richard Lugar (R-Ind.), House Ways and Means Chairman Bill Archer (R-Tex.), Representative Dan Schaefer (R-Colo.), and Representative Billy Tauzin (D-La.). Jonathan Peterson, *Chorus Builds for Radical Remake of U.S. Tax Policy*, L.A. TIMES, Apr. 6, 1995, at A1; *see also* Amy Kaslow, *Radical Tax Reforms Gain New Attention*, CHRISTIAN SCI. MONITOR, Apr. 12, 1995, at 1; Stephen Moore, *Ax the Tax*, NAT'L REV., Apr. 17, 1995, at 38, 38.

States are also getting involved. Flat tax plans have been proposed in South Carolina, Arkansas, and California. *Clarifying California*, WALL ST. J., Dec. 6, 1995, at A18; John Heilprin, *S.C. Senate Endorses Legislation for Flat Tax*, POST & COURIER (Charleston, S.C.), May 18, 1995, at A8; James Jefferson, *Rep. Reopens Plan for Ark. Flat Tax*, COM. APPEAL (Memphis, Tenn.), July 28, 1995, at B10.

2. *U.S. GOP Candidate Alexander Backs Flat Tax*, REUTERS, May 12, 1995. *But see* Rena Pederson, *Clarifying the Flat Tax*, DALLAS MORNING NEWS, Jan. 21, 1996, at 23 (reporting that Alexander recently called one flat tax plan a "nutty idea").

3. Marcia Stepanek, *Republicans Flat Excited About New Tax Proposals*, S.F. EXAMINER,

and publisher Malcolm S. "Steve" Forbes, Jr., as well as leaders in both the House and Senate,[5] expressed support for these proposals and their underlying theories during the 1996 campaign. These reform plans, advertised as revenue-neutral, suggest either replacing the current graduated income tax rate structure with a "flat" or proportionate rate, or abolishing the income tax altogether in favor of a national consumption or sales tax. The devil, however, is in the details.[6] Consequently, House Majority Leader Newt Gingrich (R-Ga.) and Senate Majority Leader Bob Dole tabbed Jack Kemp to lead a GOP commission to investigate the possibility of overhauling the tax system.[7] Regardless of which, if any, proposal survives the political process, tax reform is sure to be on the public agenda in 1996.

While the public has echoed the radical sentiments expressed by tax reformers, a basic loyalty to graduated rates remains. In a *Wall Street Journal* poll, two-thirds of respondents said that the current system was "unfair."[8] Likewise, a *Newsweek* poll found that only 27% of respondents favored the current system in which rates range from 15% to 39%.[9] Much of this dissatisfaction, however, represents a plea for simplification rather than support for the proposed alternatives.[10] Opinion surveys and focus groups reveal that "the

---

Apr. 17, 1995, at A11.

4. *Id.*

5. *Enthusiasm Growing for Income Tax Reform*, ORLANDO SENTINEL, June 9, 1995, at A3 (discussing House Minority Leader Richard Gephardt's plan to announce his proposal); John Harwood, *Presidential Hopeful Forbes Talks Up Flat Tax*, WALL ST. J., Jan. 2, 1996, at 38; Lisa Holton, *The Flat Tax; What Is It? Who Gains? Will It Fly?*, CHI. SUN-TIMES, Apr. 23, 1995, at 41; Peterson, *supra* note 1, at A1; B.J. Phillips, *Flat-Tax Fever*, TAMPA TRIB., Apr. 29, 1995, at 15. Representative Robert K. Dornan (R-Cal.), a long shot Republican presidential candidate, and Massachusetts Governor William Weld, a rumored candidate, also publicly proclaimed their support for the flat tax. Amy Bayer, *Dornan Joins GOP Presidential Race, Vows to Fight Moral Decay*, SAN DIEGO UNION-TRIB., Apr. 14, 1995, at A6; *Publisher Forbes May Seek GOP Presidential Nomination*, PALM BEACH POST, July 9, 1995, at A14; Doris S. Wong, *Weld Backs Flat-Rate U.S. Income Tax*, BOSTON GLOBE, July 20, 1995, at 46.

6. *See* Edwin Chen, *Details Divide GOP's Flat-Tax Boosters*, L.A. TIMES, May 18, 1995, at A14.

7. Gerald F. Seib, *Flat to Flatter Goes Tax Debate for Republicans*, WALL ST. J., Apr. 12, 1995, at A16. A report from the commission was released on January 17, 1996. *See* Cal Thomas, *Flat Tax: It's a Good Alternative to Our Confusing System*, DALLAS MORNING NEWS, Jan. 18, 1996, at 19A. There are also reports that President Clinton has directed the National Economic Council to evaluate the options for tax reform. Douglas Stanglin et al., *Taxing Debate*, U.S. NEWS & WORLD REP., July 10, 1995, at 14, 14.

Unfortunately, the Kemp Commission Report offered few details. Its basic prescription for reform is some type of flat rate tax which allows full deductibility of the payroll tax and requires a two-thirds super-majority vote in Congress to increase the rate. *See* REPORT OF THE NATIONAL COMMISSION ON ECONOMIC GROWTH AND TAX REFORM, UNLEASHING AMERICA'S POTENTIAL (1996).

8. Ronald G. Shafer, *Tax Overhaul? Yes. Flat Tax? Not So Fast*, WALL ST. J., Apr. 28, 1995, at A1.

9. *Poll: Majority Favors Flat-Tax Proposal*, WASH. TIMES, Apr. 9, 1995, at A2.

10. *See Keep it Simple . . .*, INDIANAPOLIS NEWS, June 8, 1995, at A6; *Make Taxes Simpler, Not Flat*, WIS. ST. J., Aug. 6, 1995, at B3; Henry G. Mogensen, *All Would Gain from Tax Reform*, WIS. ST. J., Apr. 29, 1995, at A7; *Time for Reform; Tortuous Tax System Needs Simplification*, COLUMBUS DISPATCH, May 6, 1995, at A12; *see also* Sheldon D. Pollack, *Tax Complexity, Reform, and the Illusion of Tax Simplification*, 2 GEO. MASON INDEP. L. REV. 319 (1994) (arguing that most tax reform proposals claim to simplify the tax code because this makes good press, but few come close to this goal).

long-held notion that the tax code should be 'progressive,' requiring the rich to pay a higher percentage of their income in taxes than the poor . . . remains firmly rooted in the minds of many middle-income taxpayers."[11] Thus, many resist reform when they realize that it involves a significant departure from our current system of graduated rates.[12]

Indeed, graduated rates have become entrenched in our notion of what constitutes a "fair" system of taxation. It is common to hear people suggest the somewhat oxymoronic solution of a "flat" tax which contains more than one tax rate.[13] As popular columnist William Safire wrote, "[m]ost of us accept as 'fair' this principle: The poor should pay nothing, the middlers something, the rich the highest percentage."[14] Given this "political logic of progressive taxation,"[15] Representative Sam M. Gibbons (D-Fla.), the ranking

---

11. Clay Chandler, *Will the Republicans Trip over Tax Reform? Strategists Say a Crusade Could Backfire, Painting GOP as Pawns of Corporations, Rich*, WASH. POST, Aug. 13, 1995, at H1.

12. In several *Wall Street Journal* and NBC News polls, a majority of people favored retaining graduated rates despite their eagerness for radical reform. *The Flat Tax Is Losing Its Appeal Among U.S. Voters, Poll Finds*, WALL ST. J., Mar. 8, 1996, at R2 (stating that 54% supported a graduated tax while only 39% preferred a flat tax); *see also* Christina Duff & Gerald F. Seib, *Panel Shaping GOP's Tax Plan Recommends Single Low Rate*, WALL ST. J., Jan. 18, 1996, at A6 (stating that 54% supported a graduated income tax system, while 41% supported a flat tax); Gerald Seib, *Forbes Boomlet: A Rogue Force Stalks the Field*, WALL ST. J., Dec. 6, 1995, at A20. The results in a *Newsweek* poll and a poll by *Time* and CNN, however, showed that more respondents favored some form of flat rate taxation. *Flatter Is Better, Both Parties Agree Tax System Too Complicated*, SAN DIEGO UNION-TRIB., July 7, 1995, at B6; *Poll: Majority Favors Flat-Tax Proposal*, *supra* note 9, at A2. With the majority of plans billing themselves as "flat," while still providing deductions and graduated rates, the *Newsweek* poll and the poll by *Time* and CNN may be misleading. *See Reformers Really Want a Flat Tax with Wrinkles*, PALM BEACH POST, July 15, 1995, at A14. Many respondents may be simply unfamiliar with the choices. *See* Chandler, *supra* note 11, at H1 ("Nearly seven in 10 respondents to a February CBS News/New York Times survey said they had never 'heard or read anything' about the flat tax."). At a minimum, the numbers indicate substantial support for change without substantial support for moving away from graduated rates.

13. *See A Flat Tax That America Might Buy*, BUS. WK., June 12, 1995, at 110, 110 ("We favor a modified flat tax that would flatten the rate structure into two or three rates and preserve deductions for home mortgage interest contributions."); Phillips, *supra* note 5, at 15; William Safire, *Flat Tax Plan*, TIMES-PICAYUNE, Apr. 24, 1995, at B5 (arguing for a plan in which after a $15,000 exemption, earnings up to $150,000 would be taxed at a rate of 25% and anything over that would be taxed at 30%); *Talking Straight About Taxes, Another Debate on Tax Reform Is Welcome, but Let's Not Pretend This Will Be Easy*, PLAIN DEALER, Apr. 26, 1995, at B10 [hereinafter *Talking Straight About Taxes*].

14. Safire, *supra* note 13, at B5. This is a reasonable reflection of the American attitude toward graduated rates. *See* Michael Kinsley, *The Flat Tax Society*, NEW YORKER, May 1, 1995, at 7, 8 (arguing that the wealthy should pay a disproportionate share of the taxes since they receive a disproportionate share of society's benefits); Letters to the Editor, *The Rich Should Pay Plenty*, WASH. POST, July 22, 1995, at A20.

Reaction to the Christian Coalition's endorsement of the flat tax illustrates the moral principles which many believe should underlie the tax system. One commentator wrote that "[w]hen you recall that Christ's ministry was designed to uplift the poor and bring social justice to the world, it makes you wonder why the flat tax is being called 'Christian.'" Yardley Rosemar, *Christian Coalition's Contract: But Does Jesus Favor a Flat Tax?*, NEWS & REC. (Greensboro, N.C.), May 26, 1995, at A15. A similar story is revealed by three Tennessee bishops' criticisms of sales taxes. "Tennessee takes in most of its revenue through sales taxes, and the bishops are worried that's too much of a burden on their poor. 'Jesus is on our side,' the clerics argue." *Higher Authorities*, WALL ST. J., June 8, 1995, at A12.

15. *Should America Keep Its 'Progressive' Tax System?*, INVESTOR'S BUS. DAILY, July 24, 1995, at B1 ("The political logic of progressive taxation has kept multiple rates in the U.S. tax

Democrat on the House Ways and Means Committee, declared that "'[a]ny new tax system, should result in the same tax burden on each income group as the current tax system imposes.'"[16] Thus, both the Domenici-Nunn "USA tax," which taxes income of all kinds but creates a deduction for anything a person saves,[17] and the Gephardt "flat tax," which retains five different rates,[18] have been hailed because they allow for "steeply graduated marginal tax rates."[19] According to a *Washington Post* editorial, the ability to tax high incomes at a higher rate than low ones "is consistent with a well-established American tradition of fairness."[20]

This conception that graduated, and hence progressive, rates are inherently fair is not confined to the popular press and political commentators. Academics often uncritically accept the historical supposition that the ratification of the Sixteenth Amendment[21] in 1913 sanctified the marriage between the principles of fairness and graduated rates and approved an explicitly redistributive rationale for the income tax.[22] Akhil Amar wrote that "[t]he popular legislative history of ratification [of the Sixteenth Amendment] reveals not merely an endorsement of an income tax simpliciter, but popular approval of a predictably progressive—that is, a redistributive—income tax."[23] Because the first post-Sixteenth Amendment income tax included graduated rates, the assumption is that the progression principle was also ratified in 1913.[24]

---

system for decades.").

16. David E. Rosenbaum, *Chairman Proposes Redefining Tax Code*, N.Y. TIMES, June 7, 1995, at A22. Representative Gephardt's "flat" tax proposal, which provides for rates of 10%, 20%, 26%, 32%, and 34%, is an example of the attempt to preserve the graduated structure. *See* Harper, *supra* note 1, at A2.

17. David Wessel, *Nunn-Domenici 'USA Tax' Puts Levy on Consumption to Encourage Saving*, WALL ST. J., Apr. 26, 1995, at A2.

18. Thomas Oliphant, *Gephardt's Version of Flat Tax Is Fairer to Middle Class*, BOSTON GLOBE, July 11, 1995, at 13.

19. Wessel, *supra* note 17, at A2; *see* Robert Kuttner, *Dueling Tax Plans: One Adds Up, The Other Doesn't*, BUS. WK., May 15, 1995, at 28; *Tax Fairness*, WASH. POST, Apr. 27, 1995, at A20; Murray Weidenbaum, *Postcard-Size or Not, America Needs a New Tax Plan*, CHRISTIAN SCI. MONITOR, May 18, 1995, at 19.

20. *Tax Fairness*, *supra* note 19, at A20. Tommy Denton, in his blunt fashion, noted that "all taxpayers should bear an equitable—and thus progressive—proportion of the burden necessary to support the common good, including and especially the awesomely wealthy. Fair's fair." Tommy Denton, *Let's Be Fair*, BALTIMORE SUN, July 19, 1995, at A15.

21. The Sixteenth Amendment states, "The Congress shall have the power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." U.S. CONST. amend. XVI.

22. *See* Marc Linder, *I Like Ike: Bringing Back Eisenhower-Era Progressive Taxation*, 67 TAX NOTES 833, 834 (1995) ("Bringing back Eisenhower-era progressive taxation . . . would also fulfill the other traditional purpose of the income tax by reducing the market's increasingly unequal distribution of income through redistribution."); Martin J. McMahon, Jr., *Individual Tax Reform for Fairness and Simplicity: Let Economic Growth Fend for Itself*, 50 WASH. & LEE L. REV. 459, 461 (1993) ("Advocates of changing the tax system to encourage economic growth do not seem to view the tax system as a vehicle to collect adequate revenues fairly or to soften the harsh distributional results that capitalism sometimes produces."). Some recognize that this was not the theory enacted in 1913, but imply that it should have been. *See, e.g.*, ROBERT STANLEY, DIMENSIONS OF LAW IN THE SERVICE OF ORDER: ORIGINS OF THE FEDERAL INCOME TAX, 1861-1913 (1993).

23. Akhil R. Amar, Comment, *Our Forgotten Constitution: A Bicentennial Comment*, 97 YALE L.J. 281, 291-92 & n.45 (1987) (critiquing Richard Epstein's argument that redistributive legislation offends deeply rooted Constitutional principles).

24. *See* Marjorie E. Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Move-*

The history of income taxation in this country before and immediately after the ratification of the Sixteenth Amendment, however, reveals a struggle of more than fifty years to replace a regressive tax system with a proportional, not progressive, one. Each income tax proposal was just one component of a larger tariff or revenue bill. During the three significant periods of discussion for the income tax—1861-1872, 1893-1895, and 1909-1913—the justification for income taxes, and their progressive structures, was to balance out the regressive effects of other aspects of the federal revenue system and to require the wealthy to contribute their proportionate share.[25] The only experiment with a graduated income tax prior to the Sixteenth Amendment, which was enacted to counterbalance the heavy effects of consumption taxes during the Civil War, was promptly discarded when those effects appeared to dissipate.[26] When attention later became focused on the inequity of the wealthy's equal rather than proportionately larger tax contribution, an income tax enacted in 1894 contained a flat rate similar in form to many of the recent proposals.[27] Thus, the Sixteenth Amendment's failure to address progressive rates in its approval of an income tax "without apportionment among the several States, and without regard to any census or enumeration,"[28] was not because progression was implicit within an income tax. Indeed, a motion on the floor of Congress to amend the proposed Sixteenth Amendment to allow for graduated rates was withdrawn by its sponsor, Senator Joseph W. Bailey (D-Tex.), because it would not have passed and he did not want the measure of opposition recorded.[29]

Thus, when Congress employed graduated rates in the first post-Amendment income tax measure in 1913, it was not to enact a progressive overall revenue system. These rates were politically and popularly intertwined with the tariff reduction bill within which they were contained. Under what contemporary economist Edwin R.A. Seligman called the "special compensatory theory,"[30] the Democrats who controlled the bill in both Houses supported the slightly graduated rates as a measure to equalize the overall regressive effects of the tariffs and internal excise taxes which provided the federal government with the bulk of its revenues. Operating within the patchwork quilt of federal taxation, graduated income tax rates were seen as a temporary measure necessitated by inequality elsewhere in the fabric. A transition was beginning from a system which taxed people based upon their "necessity to consume" to a system which taxed them based upon their "ability to pay." Strongly in favor of free trade, the Democrats hoped for a period when the income tax would

---

ment: A Typical Male Reaction, 86 MICH. L. REV. 465, 465 (1987) ("In 1913, the general public, economists, and politicians argued about the exact schedule of rates and exemptions, but the idea of graduated or progressive rates was accepted with surprising ease and generally has remained unquestioned ever since.") (footnote omitted).

25. *See* discussion *infra* part II.

26. *See* discussion *infra* part II.B.

27. *See* discussion *infra* part II.C.

28. U.S. CONST. amend. XVI.

29. 44 CONG. REC. 4120 (1909).

30. EDWIN R.A. SELIGMAN, THE INCOME TAX: A STUDY OF THE HISTORY, THEORY AND PRACTICE OF INCOME TAXATION AT HOME AND ABROAD 30-31 (2d ed. 1914).

become the primary source of federal revenues. At that time, Democrats declared they would cast their support for the enactment of a flat rate income tax as the only just and equal form of taxation. Only the Insurgent Republicans, a small faction of the party composed mainly of politicians from the West and Midwest, and the few members of the Progressive Party in Congress supported the principle that the wealthy should pay at a higher rate simply because of their swollen fortunes.

Despite this history, the latter view has endured. "Ability to pay" has become associated with the philosopher's notion of "equality of sacrifice" rather than the politician's description of a shift from taxation measured by the "need to consume" to taxation measured by the "ability to pay"—a shift from near absolute equality of payment to proportional equality of payment.[31] This article examines the historical underpinnings and assumptions leading up to the adoption of the graduated income tax in 1913 to disclose the fallacy that Congress intended to enact even a mildly progressive federal revenue system. Considering the system as a whole, the Revenue Act of 1913, much like its predecessors, was a political compromise which resulted in the adoption of a flat rate principle in federal taxation.

Section I explains the conceptual background and terminology of the federal revenue system. The historical argument, which begins in section II, examines the short-lived income taxes enacted during the Civil War and in 1894. Section III explores the political background and congressional debates surrounding the inclusion of a graduated rate structure in the Sixteenth Amendment and the Act of 1913. Finally, the article concludes that history supports the adoption of a flat tax principle, but not in the form suggested by many of the current proposals.

I. BACKGROUND AND TERMINOLOGY

Distributions of tax burdens can exist in a variety of manners as a percentage of an individual's overall income. Generally, the terms proportionate, progressive, and regressive refer to these burdens.[32] The proportionate tax is perhaps the easiest to understand conceptually. Each dollar of taxable income under a proportionate or "flat" tax is taxed at the same rate. Thus, a person who earns $1 must pay $.10 under a 10% flat rate system of taxation while a person who earns $100 must pay $10, one hundred times the contribution of the lower-income individual. Wealthier individuals pay higher absolute

31. *See* McMahon, *supra* note 22, at 464 ("If equity in the tax rates requires an attempt to approximate equal sacrifice or to measure 'ability to pay' across broad ranges of incomes, rates should be far more progressive than the current rate schedule.").

32. Seligman described a fourth manner of apportioning the burdens of taxation called the degressive tax, where a tax is progressive to a certain level and then proportionate thereafter. SELIGMAN, *supra* note 30, at 30. Of course, this describes all progressive taxation which does not define its upper rate by an infinite number. According to Seligman, the term "degressive taxation" is reserved for systems where a low proportional rate is seen as the normal one and lesser incomes receive an even lower rate. *Id.* Perhaps because of this philosophical uncertainty or the reality of high rates, this term is not often cited in popular literature on the subject. *But see* Kornhauser, *supra* note 24, at 471 (using the term "degressive tax").

amounts to the government, but not because their dollars are treated differently than those of other taxpayers.

In a progressive tax system, the percentage of tax paid to the government increases with income. Under our current regime, this is accomplished through graduated marginal rates. Using the above example, the individual who earns $1 pays nothing, while those earning $50 and $100 might pay $5, or 10% of income, and $20, or 20%, respectively. Progressive taxation, however, can be accomplished without graduated marginal rates. For example, a proportionate rate of taxation coupled with an exemption results in progressive taxation.[33] An exemption of $1 would relieve the earner of $1 from paying any tax at all. Individuals earning $50 and $100 would pay tax on only $49 and $99 of their respective incomes. Since the dollar removed from the $50 earner's income is a greater percentage of his income than the dollar removed from the $100 earner's income, the progressive effect is intensified. Combining a proportionate rate with a flat rebate or grant to all taxpayers achieves the same result.[34]

The regressive form of taxation has been said to be so unpopular "that the term itself has become colored."[35] Under this system, individuals pay a lower percentage of their incomes in taxes as they become wealthier. For this reason, the consumption taxes of the nineteenth and early twentieth centuries were thought to be regressive. This does not mean, however, that the absolute amount paid cannot rise with income. One percent of $100 is still a higher absolute number than 50% of $1. Thus, even under regressive rates, wealthier individuals may contribute more to the government than lower-income taxpayers.

Some of the continuing loyalty to graduated rates can be attributed to confusion over the terminology and the practical application of current proposals. Critics disparage the flat rate tax plans for their apparent lack of progression and dismiss consumption or sales tax alternatives due to their supposedly regressive effects.[36] Putting aside the normative question of what constitutes the proper distribution of tax burdens, neither criticism is fair or accurate in light of the proposals currently circulating.

For instance, all of the current flat tax proposals are progressive in the sense that each contains a generous exemption.[37] Some proposals even con-

---

33. *See* WALTER J. BLUM & HARRY KALVEN, JR., THE UNEASY CASE FOR PROGRESSIVE TAXATION 4 (1953); ROBERT E. HALL & ALVIN RABUSHKA, LOW TAX, SIMPLE TAX, FLAT TAX 25 (1983).

34. *See* Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CAL. L. REV. 1905, 1908 (1987).

35. BLUM & KALVEN, *supra* note 33, at 3.

36. *See, e.g.*, Edwin Chen, *Administration Opposes Consumption Based Tax Plan*, L.A. TIMES, June 8, 1995, at A18; Dan Schaefer, *Beyond Repair, Sales Tax Best 'Reform' for Unfixable Income Tax Code*, ROCKY MTN. NEWS, May 21, 1995, at A98; *Talking Straight About Taxes*, *supra* note 13, at B10; *Tax Reform Pitfalls*, SACRAMENTO BEE, Apr. 27, 1995, at B6; Weidenbaum, *supra* note 19, at 19. As will be discussed in the conclusion, most of the flat tax plans, through their exemption of all investment income and capital gains, amount to consumption tax plans, effectively blurring the distinction between the two.

37. *See* Louis S. Richman, *The Flat Tax*, FORTUNE, June 12, 1995, at 36. Under Senator Specter's plan, "Four-person households with incomes below $25,500 would pay no tax at all." Stepanek, *supra* note 3, at A11. Under Representative Armey's plan, individuals would get a

tain multiple rates to the extent that charitable, religious, and educational organizations retain their tax exemptions.[38] Studies estimate that because of tax avoidance schemes, the present effective tax rate paid by the top 5% income group is only 17.4%, rather than the nearly 40% top marginal rate imposed by statute.[39] Thus, Representative Armey's proposal, a phased-in 17% tax rate on earned income over and above a standard deduction of $24,700 for a married couple filing jointly plus an additional standard deduction of $5,000 for each dependent, coupled with a proposed elimination of deductions, should be considered no less progressive than the current system. Critics respond that certain deductions actually promote progressivity by targeting lower-income individuals or by encouraging income redistribution.[40] Senator Specter's plan to institute a 20% tax rate on earned income above $16,500 plus an additional $4,500 for each dependent, however, partially addresses this concern because it preserves the deduction for up to $100,000 of home mortgages and the deduction for charitable contributions.[41] Flat rate proposals, therefore, are not only progressive, but potentially as progressive as the current system. In effect, the existence of a flat rate is meaningless as a measure of a proposal's progressivity.[42]

Consumption or sales tax plans are equally undeserving of the criticism directed toward them. Critics contend that sales taxes are regressive because the money paid constitutes a larger percentage of a poor person's income than of a wealthier person's income. This logic assumes, however, that the poor and wealthy spend their money in the same way. Since we know that this is not true, legislators could construct a sales tax as progressive as any other form of taxation. For example, Senator Lugar's plan exempts from the tax food and medicine and a minimum number of purchases by the poor.[43] Senators Nunn and Domenici go one step further in their tax plan by explicitly

---

personal allowance of $10,700, married joint-filers would get $21,400, and there would be an extra $5,000 deduction for each dependent child. Jackie Calmes, *Flat-Tax Plan Is Revised by Rep. Armey to Reduce Projected Loss of Revenue*, WALL ST. J., July 20, 1995, at A14. Thus, a family of four earning $50,000 would pay about 6% in taxes while a family earning $200,000 would pay about 14%. *Id.* Professors Blum & Kalven describe this "inescapable" increment of progression as "keyed to at least a minimum subsistence standard of living," and thus discuss "whether any added degree of progression" can be justified. BLUM & KALVEN, *supra* note 33, at 4. However, given the expansive exemptions proposed, with a family of four not paying taxes at all until its income reaches $36,800, it is hard to ignore this exemption as an independent basis for progression. *See* Robert S. Stein, *Is a Major Tax Overhaul Ahead?*, INVESTOR'S BUS. DAILY, Apr. 13, 1995, at A1.

38. *Hearings on Flat Tax Proposals Before the Senate Committee on Finance*, 104th Cong., 2d Sess. (May 18, 1995) (statement of Michael J. Graetz, Professor, Yale Law School), *available in* LEXIS, Nexis Library, Federal Document Clearing House Congressional Testimony, CURNWS File [hereinafter *Hearings*].

39. Bradley D. Belt, *Flat, Flatter, Flattest: Singing from the Same Tax 'Hymnal'*, CHRISTIAN SCI. MONITOR, May 12, 1995, at 19 (citing a recent study by Jonathan Gruber of MIT, published in a Progressive Policy Institute report).

40. *See* Holton, *supra* note 5, at 41.

41. Gerald F. Seib, *GOP Sen. Specter, Advocating Flat Tax, Religious Tolerance, Seeks Presidency*, WALL ST. J., Mar. 31, 1995, at A14.

42. *Cf.* Scott Shepard, *Flat Tax Fever; 'Dream Bill' Catches Fire, Draws Flack*, PALM BEACH POST, Apr. 15, 1995, at A10 ("I've never thought a steeply graduated tax code was progressive—or even fair, for that matter. The progressivity of the (flat) tax code is in exempting the poor from income tax rates.") (quoting Jack Kemp).

43. Stein, *supra* note 37, at A1.

allowing for graduated rates ranging from 19% to 40%.[44] A rebate or credit which would simulate the flat tax's exemption for a base level of consumption may even accompany a consumption tax.

Thus, even if one measures "fairness" by the progressivity of the tax, it is not a function of the graduation of the rates. A flat tax can be highly progressive if enough people are completely exempt from paying a tax, while a graduated rate tax can become regressive if the bulk of the deductions favor the wealthy. A common mistake is to debate the merits of a plan based upon its ability to achieve a particular distribution of tax burdens, without considering the grounds for preferring that distribution. Legislators should determine how to allocate the tax burdens and then decide the simplest and most efficient method of accomplishing this result.

We must, therefore, evaluate the theories for deciding whether the tax system should be progressive, proportionate, or regressive. Philosophers and political commentators have expounded on the proper distribution of tax burdens since taxation began. Although universally rejected by theorists, the "pseudo-democratic contention of strict dollar for dollar equality died hard," in the minds of the public during the nineteenth century.[45] Absolute equality of payment was inherent within poll taxes, stamp taxes, and many forms of consumption taxes. Philosophers, however, scoffed at the morality of this type of distribution. Instead, philosophers primarily discussed four theories between 1861 and 1913 as bases for the distribution of the tax burdens: (1) the sacrifice theory; (2) the benefit theory; (3) the redistributive theory; and (4) the compensatory theory.

From the beginning, philosophers were drawn to the sacrifice theory. "The most pronounced early support for progressive taxation, as well as '[t]he largest part of the intellectual history of progression theory has been the development of the sacrifice doctrine.'"[46] John Stuart Mill, in *Political Economy*, stated,"'The true principle of taxation'" is that each person "'shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his.'"[47] Mill premised his argument upon the notion that certain goods were necessities while others were luxuries.[48] Everyone first devoted their income to necessities until achieving a certain point of satiation, whereupon they could spend their remaining income on luxuries.[49] Since taxes are presumably drawn off the top of a person's income, a head tax takes away from a poor person's necessities while merely cutting back a rich person's luxuries. Thus, the rich person must pay more to feel the same sacrifice as the poor person. The difficulty with this argument is its practical im-

---

44. Wessel, *supra* note 17, at A2.

45. JOHN D. BUENKER, THE INCOME TAX AND THE PROGRESSIVE ERA 8 (1985).

46. Jay M. Howard, *When Two Tax Theories Collide: A Look at the History and Future of Progressive and Proportionate Personal Income Taxation*, 32 WASHBURN L.J. 43, 63 (1992) (alteration in original) (quoting Walter J. Blum & Harry Kalven Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417, 456 (1952)).

47. STEPHEN F. WESTON, PRINCIPLES OF JUSTICE IN TAXATION 187-88 (1903) (quoting 5 JOHN S. MILL, POLITICAL ECONOMY, ch. 2, § 2 (N.Y., D. Appleton & Co. 1888)).

48. *Id.* at 188-89.

49. *Id.*

plementation. As Edwin R.A. Seligman conceded, "Equality of sacrifice, indeed, we can never attain absolutely or exactly, because of the diversity of individual wants and desires."[50] In order to combat this difficulty, philosophers often translated the negative conception of "equality of sacrifice" into the positive indicia of taxation based upon "ability to pay." Sometimes called the "faculty theory," one receives an exemption for income presumed necessary to satisfy basic individual needs.[51] Thus, under this theory, only the "clear" income is taxed. Beyond that, the principle that "ability increases in a greater ratio than income" warrants a progressive rate.[52] While politicians often cited the phrase "ability to pay" to justify the transition from a consumption-based tax system, it did not always coincide with the philosophers' use of this term.[53] For example, politicians often justified property taxes because they taxed based upon the "ability to pay,"[54] yet they were more proportional than progressive.

The benefit theory, although sometimes scoffed at by intellectuals, had political appeal in the Gilded Age. Under the benefit theory, "[f]or every 'benefit' there must be a corresponding tax."[55] No exemption is defensible under this theory, since even an individual without property needs protection of his or her person.[56] Theoretically, this suggests a proportionate tax since under a fair and impartial government, the benefit of protection does not necessarily increase geometrically with respect to income.[57] Under the political circumstances of the day, when the public perceived that special laws and government favors resulted in huge fortunes being amassed in large monopolies and heavily protected industries, the benefit theory supported at least a temporary progression in the system. Today, libertarians and free market advocates sometimes invoke the benefit theory because of its analogy to bargained-for consideration in a contractual exchange.[58]

The redistributive rationale is premised on the assumption that progression redistributes income to benefit society's welfare. This can operate in a theoretical or practical sense. On a theoretical level, a small increase of money in a poor person's pocket increases his or her welfare more than that same amount in a wealthy person's pocket.[59] On a practical level, politicians have long

---

50. SELIGMAN, *supra* note 30, at 32. Seligman thought this problem could be overcome by recognizing that marginal utility theory supports some level progression in the system. *Id.* at 32-33. This argument is not necessarily true even in the abstract. *See Should America Keep Its 'Progressive' Tax System?*, *supra* note 15, at B1.

51. SELIGMAN, *supra* note 30, at 31.

52. WESTON, *supra* note 47, at 241.

53. Stephen Weston, a student of Seligman, who later became president of Antioch College in Ohio, noted that many confuse the benefit and ability theories and thus advocate proportional taxation under the guise of the "ability to pay" concept. *Id.* at 226 & n.2.

54. STANLEY, *supra* note 22, at 25.

55. WESTON, *supra* note 47, at 247.

56. *Id.*

57. *See id.* at 226.

58. For a discussion of this modern development, see Kornhauser, *supra* note 24, at 491. Liberal scholars still invoke the traditional notion of the benefit theory to justify progressive rates. *See* Kinsley, *supra* note 14, at 8.

59. *See* Blum & Kalven, *supra* note 46, at 477 (agreeing with this intuitive notion, while ultimately rejecting a redistributive rationale for progression).

recognized that an extreme disparity in income can lead both to excess power and the arbitrary exercise thereof on the part of the wealthy. In turn, the poor become resentful and threaten radical action against a nation's basic institutions.[60] Thus, some measure of redistribution of wealth operates in a real sense to reduce that excess power, and in a symbolic sense to defuse the poor's anger with respect to both wealth and the wealthy.[61]

Modern observers have paid little attention to the fourth rationale for distributing the benefits of taxation, the compensatory theory. Despite the wide acceptance of the compensatory theory's notion that some degree of progression is necessary to compensate "for the regressivity of other taxes in our overall tax system," Professors Walter Blum and Harry Kalven decided to forego discussion of it, concluding that "it does not involve the adoption of the principle [of progression] itself."[62] But as Jerold Waltman explained, the theory was of central importance to early supporters of the graduated income tax:

> One of the key supporting arguments for progression in income taxes, especially in the early years, was that it helped to offset the regressive character of other taxes, especially the customs duties. Customs duties had the double effect of taxing consumers through higher prices and enriching American manufacturers. A graduated income tax, therefore, would redress this inequity.[63]

Seligman called this the "special compensatory theory" to distinguish it from the general compensatory theory.[64] General compensatory theory combined the redistributive and benefit rationales to reason that "'taxation ought to counterbalance the inequalities consecrated by custom and by law'"[65] whereby "the legal conditions of society naturally favor the rich."[66] Under the special compensatory theory, one form of taxation is made progressive to counterbalance the regressive effects of another specific form of taxation. Thus, Seligman explained:

> When indirect taxes exist, they often, it is said, act regressively and hit the poor harder than the rich. The direct tax, with its progressive scale, is designed to act as an engine of reparation. In order to attain equal treatment the regressive indirect taxes must be counterbalanced by the progressive direct tax.[67]

Under the special compensatory theory, therefore, the graduated income tax may be only an example of "ostensible progression," advocated by those

---

60. *See* STANLEY, *supra* note 22, at 234. The populist movement is an example of the view that the government and the rich conspire against the poor in times of great disparity causing the poor to become desparate and threaten violence. *See* Barbara B. Woodhouse, *Who Owns the Child?*, 33 WM. & MARY L. REV. 995, 1023-24 (1992).

61. Robert Stanley argued that the income tax between 1861 and 1913 was primarily to address the anger of the poor. STANLEY, *supra* note 22, at 234.

62. BLUM & KALVEN, *supra* note 33, at 5 & n.10.

63. JEROLD L. WALTMAN, POLITICAL ORIGINS OF THE U.S. INCOME TAX 10 (1985).

64. EDWIN R.A. SELIGMAN, PROGRESSIVE TAXATION IN THEORY AND PRACTICE 146 (2d ed. 1908).

65. *Id.* at 144 (quoting French writer Villiaumé) (citation omitted).

66. *Id.*

67. *Id.* at 146.

willing to accept progression in one area in order to achieve the overall goal of proportionate taxation.[68] Although not a mathematically precise counterweight, a graduated income tax "is a crude way of accomplishing some kind of proportionality overall."[69] This article argues that under the compensatory theory the United States was striving toward the overall goal of a flat or proportionate tax system during the period before and immediately after the ratification of the Sixteenth Amendment.

II. THE HISTORY OF INCOME TAX

A. *Early Efforts at an Income Tax*

Over the last fifty years, income and payroll taxes have accounted for the majority of federal revenues.[70] This, however, was not always the case. In the nineteenth and early twentieth centuries, the United States relied on high tariffs and excise taxes as its principle source of revenues.[71] This reliance was so great that by the 1850s, the federal tax system was dependent on import duties for 92% of its overall revenues.[72] The tariff schedules, publicly justified as protection for domestic industries and privately as rewards for special interests,[73] included manufactured goods, raw materials, consumer products, and luxury items, and covered industries in every part of the country.[74] The import duties on food, clothing, and shelter items, however, brought in the bulk of the tariff revenues.[75] Implicit in the notion that such indirect taxes need not be apportioned among the states was the expectation that the duties would be passed along to consumers in the form of higher prices.[76] Given the finite limit on an individual's ability to consume, a general understanding existed that the poor spent a greater percentage of their incomes on such goods than the wealthy.[77] Since domestic manufacturers were the beneficiaries of the duties, the regressive effect was exacerbated. Although this effect may have been minimized in some respects by the reliance on property taxes

---

68. *Id.* at 146-47.

69. CHARLES O. GALVIN & BORIS I. BITTKER, THE INCOME TAX: HOW PROGRESSIVE SHOULD IT BE? 22 (1969).

70. Professor Sheldon Pollack recently testified before the Senate Finance Committee that the income tax accounted for 45% of federal receipts from all taxes in 1950, jumping to nearly 73% in 1985, with a projected $739 billion in 1995. *Hearings, supra* note 38 (testimony of Sheldon Pollack); *see* SIDNEY RATNER ET AL., THE EVOLUTION OF THE AMERICAN ECONOMY 518 (1979) (concluding that income and payroll taxes added up to about 70% of total tax revenues in the late 1970s).

71. Pete V. Domenici, *The UnAmerican Spirit of the Federal Income Tax*, 31 HARV. J. ON LEGIS. 273, 275 (1994); Jay Starkman, *Is a Consumption Tax the Answer?* ATLANTA J. & CONST., Apr. 26, 1995, at A15. In 1914, the federal income tax accounted for a mere 9.7% of the total receipts of the federal government. *Hearings, supra* note 38 (testimony of Sheldon Pollack).

72. STANLEY, *supra* note 22, at 25.

73. Daniel K. Tarullo, *Law and Politics in Twentieth Century Tariff History*, 34 UCLA L. REV. 285, 289-90 (1986).

74. STANLEY, *supra* note 22, at 25-26.

75. *Id.* at 26.

76. *Id.* at 25. John D. Buenker concluded that "virtually the entire cost of [customs duties] was added on to the eventual price paid by the consumer." BUENKER, *supra* note 45, at 31.

77. BUENKER, *supra* note 45, at 31-32; STANLEY, *supra* note 22, at 26.

at the state and local level,[78] it still energized the national debate over how to allocate the hardships of federal taxation.

Initially, the income tax was a method for reaching the pockets of people who escaped taxation altogether. Legislators made the first proposal for a federal income tax toward the end of the War of 1812, after war expenditures had produced a national debt of $100 million.[79] When the war began, the national government doubled the customs duties it had been using to raise the majority of its revenue.[80] As the drop in trade caused these sums to dwindle, Thomas Jefferson's Secretary of the Treasury, Alexander Dallas, turned to internal revenues from excise and property taxes, and eventually, to proposals for income and inheritance taxes.[81] In light of the relative tax burdens, Dallas may have been motivated by a desire to impose some of the costs of financing the war on the nation's manufacturers and financiers.[82] Although the latter push came too late to secure passage,[83] some believe the country only escaped income taxation "by a close margin."[84] Instead, Congress adopted a high protective tariff in 1816.[85]

A crude version of a state income tax already existed prior to the Civil War. Several states imposed "faculty" taxes on income from professions, trades, and employments during the colonial period "as an adjunct to the property tax."[86] The advent of professions and income derived from sources other than real property made the property tax incomplete. "Since most colonial revenue was derived from imposts on real and personal property, the faculty tax was designed to reach 'those persons who derived their income from other sources.'"[87] Most states abandoned or ignored these attempts soon after the turn of the century.[88] After the Panic of 1837, however, many states found themselves mired in financial difficulties.[89] Presidents Andrew Jackson and Martin Van Buren had withdrawn funds from federal improvement projects,[90]

---

78. RATNER ET AL., *supra* note 70, at 517.

79. JOHN F. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX 67 (1985).

80. *Id.*

81. BUENKER, *supra* note 45, at 2-3; WITTE, *supra* note 79, at 67. Henry Carter Adams reported that the normal income from customs duties was about fourteen million dollars, but the actual income for the years 1812 to 1816 fell far short of this despite the doubling of rates. HENRY C. ADAMS, TAXATION IN THE UNITED STATES, 1789-1816, at 69 (N.Y., Burt Franklin 1884).

82. BUENKER, *supra* note 45, at 3.

83. *Id.*

84. RANDOLPH E. PAUL, TAXATION IN THE UNITED STATES 8 (1954).

85. In the Tariff Act of April 27, 1816, the average duty was raised to 20%. BENDER'S FEDERAL REVENUE LAW 352 (1917); WITTE, *supra* note 79, at 67. While these first duties were moderate by late nineteenth century standards, a twenty-year stretch of increasingly protectionist enactments followed. PERCY ASHLEY, MODERN TARIFF HISTORY 142 (3d ed. 1920).

86. SELIGMAN, *supra* note 30, at 397-99 (discussing the faculty taxes in Vermont, Connecticut, Rhode Island, New Hampshire, Massachusetts, South Carolina, Delaware, Maryland, and Pennsylvania). John D. Buenker reported that "[a]n estimated one-third of the states partially financed the costs of the Revolutionary War through some variation of the faculty tax." BUENKER, *supra* note 45, at 2.

87. BUENKER, *supra* note 45, at 1.

88. *See* SELIGMAN, *supra* note 30, at 388-400.

89. *Id.* at 400.

90. WITTE, *supra* note 79, at 400 n.2.

and efforts to have Congress assume some of the states' increasing indebtedness were unsuccessful.[91] As a result, six states turned to some form of income taxation.[92] Not all of the push, however, should be attributed to a desire to make up for the lost revenues. Underlying many of the laws was a desire to equalize the tax burdens in the wake of the development of "paper" wealth and salaried workers.[93]

Two states, Pennsylvania and Maryland, attempted to raise revenue by imposing a tax on salaries and a lesser tax upon incomes and profits derived from professions, faculties, and employments.[94] As revenue raisers, however, the income tax was an abject failure for both states. In 1843, Pennsylvania's income tax raised $1,386 out of a total taxation revenue in the state of $910,000.[95] Maryland's tax fared no better, and in 1850, after collecting no income tax in the previous year, the law was gutted of all its force.[96]

The four southern states which instituted a form of income tax during that period (Virginia, North Carolina, Alabama, and Florida) may have had different motivations. According to Seligman, the income tax in these states was partly "a concession to the demand for more equal taxation."[97] In some of the states, such as Alabama, cotton factors, merchants, and the professional classes had escaped the brunt of taxation which was borne primarily by large plantation owners.[98] Thus, in 1843, Alabama imposed a tax of $.25 on every $100 of income from auctioneers, factors, cotton brokers, and commission brokers.[99] The following year, Alabama added a tax of .5% on the incomes of professionals such as lawyers, doctors, government officials, bankers, professors, and employees of mercantile houses.[100] By contrast, North Carolina's income tax was primarily directed at the failure to tax so-called "unearned income." Passed in 1849 with a statement in the preamble that "there are many wealthy citizens of this state who derive very considerable revenues from moneys which produce interest, dividends and profits, and who do not contribute a due proportion to the public exigencies of the same," the act imposed a 3% tax on all interest and investment income.[101] Virginia straddled the fence between these two approaches. In 1843, it imposed a tax on three separate classes of receipts: income from employment, fees from professions, and interest or profit from investment.[102] By 1853, Virginia graduated the tax on income and fees up to 1% on amounts over $1,000, while that

91. SELIGMAN, *supra* note 30, at 400.
92. WITTE, *supra* note 79, at 400 n.2.
93. STANLEY, *supra* note 22, at 25.
94. SELIGMAN, *supra* note 30, at 400-01. Maryland exempted income derived from taxed property. *Id.* at 401. This indicates that Maryland wanted to balance the tax burdens.
95. *Id.* at 400.
96. *Id.* at 401.
97. *Id.* at 402.
98. *Id.*
99. *Id.* at 404.
100. *Id.* at 404-05. Florida's tax was quite similar to Alabama's. *See id.* at 405.
101. *Id.* at 403-04. The law contained an exemption for investment income below $60 and also imposed a $3 annual tax on all professionals after their fifth year of practice provided their income exceeded $500. *Id.* at 404.
102. *Id.* at 402-03.

portion of the tax on investment applied to income from public securities climbed from 2.5% to 3.5%.[103] Apparently, the experiment with graduation was not successful or was no longer needed. Thus, in 1861 before the war began, Virginia replaced the graduated rate structure with a proportional tax of 1% on the amount in excess of $500.[104] Virginia's tax earned an appreciable amount of income during this period.[105] In general, however, most pre-Civil War state income taxes proved to be utter failures. Inadequate administration and lack of enforcement resulted in repeal or pitifully small revenues. The failure to properly administer and enforce the taxes, however, should not obscure the attempt to employ the income tax as a means of compensating for the inequality in state tax burdens.

B. *Civil War and Reconstruction*

Despite its inauspicious beginnings in this country, Congress not only adopted the first federal income tax at the onset of the Civil War,[106] but adopted one with explicitly graduated rates. Initially, Congress attempted to generate revenue without resorting to an income tax. Abraham Lincoln assumed the presidency in March of 1861 carrying a debt of almost $75 million, which was likely to increase under the weight of the war.[107] Salmon Chase, Lincoln's Secretary of the Treasury, proposed deficit reduction measures including a combination of Treasury notes, stepped-up sales of public lands, and increased tariffs and excise taxes.[108] The House Ways and Means Committee also prepared two bills designed to raise revenues from foreign and domestic sources.[109] The first imposed duties on tea, coffee, and sugar.[110] The second levied taxes on whisky, beer, porter, carriages, promissory notes, bank bills, and imposed a license tax.[111] Controversy soon developed, however, because the impact of the bills, especially on the price of such basic commodities as tea, coffee, and sugar, fell disproportionately on the poorer classes.[112] This effect only exacerbated the burden on consumers who, prior to the Civil War, had borne almost the entire weight of taxation derived from customs duties and excise taxes.[113] Since Congress would likely cut the rates in the two

---

103. *Id.* at 403.
104. *Id.* at 407.
105. *Id.* at 406.
106. WITTE, *supra* note 79, at 67.
107. *Id.*
108. *Id.* On July 17 and August 5, 1861, Congress passed loan acts which empowered the "Secretary to borrow $250 million in three-year, 7.3 per cent Treasury notes, or in twenty-year bonds not exceeding 7 per cent." SIDNEY RATNER, TAXATION AND DEMOCRACY IN AMERICA 64 (1980). Lawrence Friedman suggested that part of the initial preference for methods other than direct taxation was the concern for encroaching on state sovereignty more than it already had. LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 564 (2d ed. 1985).
109. RATNER, *supra* note 108, at 64.
110. *Id.*
111. *Id.*
112. *Id.*
113. Daniel L. Simmons, *The Tax Reform Act of 1986: An Overview*, 1987 B.Y.U. L. REV. 151, 152.

bills, the Ways and Means Committee decided to also submit a plan for direct taxation.[114]

On July 23, 1861, Thaddeus Stevens, the Republican chair of the Committee, described as "powerful," "domineering," and "dictatorial," proposed a $30 million direct tax on land, with each state's share to be apportioned by population.[115] This evoked another round of controversy. Farmers would bear the brunt of this tax,[116] as consumers bore the brunt of the excise taxes and customs duties. Those with large holdings of stock, however, would be virtually exempt from taxation.[117] Thus, the House initially recommitted the bill with instructions to amend it to include a tax on "real and personal estate."[118] When the Committee was unable to accomplish this in a constitutional manner, the bill was again recommitted with instructions to reduce the direct tax portion and to add an income tax.[119] Justin S. Morrill, a Vermont Republican and chair of the Ways and Means Subcommittee on Taxation, returned to the floor of the House on July 29 with a new bill combining an income tax with a direct tax reduced by one-third from Stevens' original proposal.[120] Morrill argued for a tax which imposed an equality different from that imposed by the consumption taxes or apportioned by direct taxes (which both focused on equality of payment): a tax "not upon each man an equal amount, but a tax proportionate to his ability to pay."[121]

In the meantime, Republican Senator James F. Simmons, a Rhode Island manufacturer, proposed adding an income tax provision to the tariff bill which was passed in the House on July 18 and introduced in the Senate on July 25.[122] As in the House, the impetus for the income tax was not to shift the tax burden entirely, just to distribute it more equally. Simmons attempted to minimize the impact of the increase in customs duties by discussing them in the context of the previous forty years' rates, but the effect was still a doubling of the rates in just four years.[123] Thus, the income tax was designed to balance the burden on consumption. Republican Senator William Pitt Fessenden of Maine concurred in this decision, announcing that "I am inclined very much to favor the idea of a tax upon incomes for the reason that, *taking both measures together*, I believe the burdens will be more equalized on all

114. RATNER, *supra* note 108, at 64.

115. PAUL, *supra* note 84, at 8-9; RATNER, *supra* note 108, at 64; WITTE, *supra* note 79, at 67.

116. *See* RATNER, *supra* note 108, at 64.

117. *See id.*

118. *Id.*

119. *Id.* at 64-65.

120. *Id.* at 65; *see* CONG. GLOBE, 37th Cong., 1st Sess. 323 (1861) (statement of Rep. Thomas R. Horton) (R-N.Y.).

121. CONG. GLOBE, 37th Cong., 2d Sess. 1194 (1862).

122. RATNER, *supra* note 108, at 66; *see* CONG. GLOBE, 37th Cong., 1st Sess. 254 (1861).

123. *See* CONG. GLOBE, 37th Cong., 1st Sess. 254 (1861). According to Senator Simmons, the rates during the last forty years ranged from 14.5% to 38%. *Id.* Thus, the proposed rate in the tariff bill of 31 7/8% did not appear so high. *Id.* In 1857, however, the rate was 16% on the entire schedule (taking into account both dutiable and free goods) and in the Act of 1860 the rate was increased to 21 7/8%. *Id.* The actual increase in rates was both swift and substantial.

classes of the community, more especially on those who are able to bear them."[124]

On July 29, 1861, both the House and Senate passed bills combining an income tax with other revenue-raising measures.[125] The House measure proposed a tax of 3% on incomes above $600 while the Senate proposed a tax of 5% on incomes above $1000.[126] A compromise returned by the Conference Committee preserved all of the changes proposed by the Senate in the tariff and direct tax rates.[127] Accompanying these measures was a 3% tax on incomes exceeding $800, which the Committee raised to 5% on income derived from property owned by United States citizens residing abroad.[128] Additionally, Congress taxed income from Treasury notes or other U.S. securities at 1.5% in order to spur the purchase of war bonds.[129] Finally, Congress allowed a deduction for national, state, or local taxes imposed on property from which income is derived.[130] Thus, the first income tax was essentially a flat rate tax designed to equalize the burdens imposed by the other revenue raising measures with which it was passed.

Passage of a bill permitting the use of an income tax, however, did not translate into the actual assessment of an income tax. Chase succeeded in frustrating the bill through delay. He made no effort to assess or collect any taxes and he made every effort to persuade Congress of the wisdom of this strategy.[131] This tactic would not work for long. The financial burdens of the war were mounting by 1862.[132] In January of 1862, banks throughout the country suspended specie payment and the government followed suit, virtually curtailing private and public credit.[133] Ignoring Chase's modest request that $50 million be raised through new internal taxes, Congress passed a resolution on January 21, 1862, calling for the imposition of a tax which, when combined with the tariff, would raise at least $150 million.[134]

In response to this congressional resolution, the House Ways and Means Committee submitted a bill on March 3, 1862 which provided for revenue through a combination of internal taxes, income taxes, and an inheritance tax.[135] The bill taxed incomes exceeding $600 at 3%, which was similar to the 1861 tax except for the lowered exemption.[136] In introducing the bill, Justin Morrill stated that the provision for an income tax, though perhaps "the least defensible," was necessary to prevent salaried workers from escaping

---

124. *Id.* at 255 (emphasis added); RATNER, *supra* note 108, at 66.
125. WITTE, *supra* note 79, at 68.
126. *Id.*
127. RATNER, *supra* note 108, at 66-67.
128. *Id.* at 67.
129. *Id.*
130. J.S. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS, 1938-1861, at 1042 (1938).
131. RATNER, *supra* note 108, at 70; Paul C. Roberts & Lawrence M. Stratton Jr., *The Roots of the Income Tax*, NAT'L REV., Apr. 17, 1995, at 42.
132. WITTE, *supra* note 79, at 68.
133. RATNER, *supra* note 108, at 68-69.
134. *Id.* at 69.
135. *Id.*
136. *Id.* at 72.

taxation altogether.[137] While the Committee was concerned about the possibility that the income tax would subject some forms of income to double taxation, Thaddeus Stevens closed his comments by noting that

> the committee thought it would be manifestly unjust to allow the large money operators and wealthy merchants, whose incomes might reach hundreds of thousands of dollars, to escape from their due proportion of the burden. They hope they have succeeded in excluding from the tax the articles and subjects of gain and profit which are taxed in another form.[138]

After the bill passed the House and was sent to the Senate,[139] the Senate Finance Committee left the flat rate income tax unchanged, but struck the direct tax provision of the bill.[140] Senator Fessenden was the lone member of the Finance Committee to vote to retain that provision and, confessed, "I am afraid the majority against me will be about as large in the Senate as it was in the committee."[141] After the Senate voted to strike the direct tax, Simmons proposed that the income tax rates be raised and made graduated to make up for the lost income.[142] With no objection to this amendment, Fessenden introduced it before the full Senate.[143] The amendment as passed by the Senate proposed a 3% tax on incomes between $600 and $10,000, a 5% tax on incomes between $10,000 and $50,000, and a 7.5% tax on the excess over $50,000.[144] A conference committee resolved the differences between the Senate and House versions by eliminating the highest rate, but preserving the principle of graduated rates introduced by the Senate.[145] Rather than eliminating the direct tax as the Senate had proposed, the Committee chose to suspend it for two years.[146]

Sidney Ratner suggested that the graduated income tax rate structure introduced in the 1862 act "was not adopted for its own sake but as a byproduct of the increase in the rates."[147] John Witte expanded upon this sentiment, stating that "progressivity was introduced not out of concern for equity, but rather to increase revenues."[148] Although there was discussion of the need for revenue, the concept of equity was underlying. When told that the final bill removed the direct tax and retained the graduated income tax rates passed in the Senate, Representative Alexander Hamilton Rice (R-Mass.), "protest[ed] against that kind of injustice" flowing from such a "discrimination."[149] Ac-

---

137. CONG. GLOBE, 37th Cong., 2d Sess. 1196 (1862).
138. *Id.* at 1577.
139. *Id.* The margin of victory was an overwhelming 125 to 14. *Id.*
140. RATNER, *supra* note 108, at 72.
141. CONG. GLOBE, 37th Cong., 2d Sess. 2350 (1862).
142. *Id.* at 2486.
143. *Id.*
144. *Id.*
145. *Id.* at 2891 (statement of Rep. Thaddeus Stevens) (R-Pa.); *see* Act of July 1, 1862, ch. 119, 12 Stat. 432, 473, *repealed by* Act of June 30, 1864, ch. 172, 13 Stat. 223, 303.
146. RATNER, *supra* note 108, at 73. Congress repealed the direct tax in 1864. *Id.*
147. *Id.* at 72.
148. WITTE, *supra* note 79, at 69.
149. CONG. GLOBE, 37th Cong., 2d Sess. 2891 (1862).

cording to Rice, replacing the direct tax with the graduated rates exempted the property-owning farmers from taxation altogether, while increasing the burden on the owners of income-producing industry.[150] Rice stated, "I am at a loss to know upon what principle of justice one class of industry should be taxed five per cent. upon its industry and another class of industry exempted from such taxation."[151] Stevens responded that "we resisted the suspension of the direct tax after the present year as long as we could without losing the bill, and I did not think it proper to lose the bill rather than suspend that direct tax."[152]

Concluding that equity was an afterthought concedes too much and ignores aspects of the debates. Removal of the direct tax affected provisions other than the income tax. Consumption taxes assumed their share of the burden.[153] Senator Zachariah Chandler (R-Mich.) criticized the bill because he believed that if it imposed a 3% tax on consumption, it should equally impose a 3% tax on income. Chandler stated:

> You tax the day laborer moderately on his consumption, three per cent., a very small item indeed; and you tax the man of wealth the same way, and if you tax him in the same ratio for his income, he feels the satisfaction of knowing that this is a reasonable burden, a burden which he ought to bear, and thus you induce men rather to enlarge than to diminish their incomes under the feeling of justice, equity, and propriety.[154]

Senator Simmons stood up to justify the graduated rates, explaining that "the consumption of this country has twenty-five per cent. put on it by this bill."[155] He continued, "[t]he poor people pay as much, and rather more, generally, than rich men on their consumption."[156] Thus, he saw the graduation in the income tax as a counterbalance to equivalent rises in the tax on consumption. Citing the example of sugar, he stated, "We put three quarters of a cent on sugar last March a year ago, and now it is two and a half cents. The taxes have been increased in consequence of the rebellion. I find no trouble in my own mind in levying this income tax."[157] Similarly, Timothy Otis Howe, the radical Republican Senator from Wisconsin,[158] responded to the argument that the agricultural sector was now exempt from taxation by pointing out that "the great amount of this revenue is to fall upon consumption, and consump-

---

150. *Id.*
151. *Id.*
152. *Id.*
153. PAUL, *supra* note 84, at 10.
154. CONG. GLOBE, 37th Cong., 2d Sess. 2486 (1862).
155. *Id.*
156. *Id.*
157. *Id.* The price of sugar during the war was particularly volatile. The wholesale price of sugar rose from 9 cents a pound in 1861 to 23.5 cents a pound in 1864. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, HISTORICAL STATISTICS OF THE UNITED STATES: COLONIAL TIMES TO 1970, pt. 1, at 209 (1975) [hereinafter HISTORICAL STATISTICS].
158. RATNER, *supra* note 108, at 72.

tion is not limited to the eastern cities; it is regulated by the number of individuals."[159]

Adoption of the progressive principle occurred against the backdrop of the other taxes in the bill—taxes which imposed a much heavier burden on the poorer classes. Although war expenses had increased considerably by 1864, the lower rate for income from treasury securities in the 1862 Act allowed Congress to finance much of its efforts through private creditors.[160] By 1863, due to the efforts of the Confederate navy and to the benefits of rate manipulation,[161] Congress received ten times more income from the sale of federal securities than from tariffs.[162] Thus, when Justin Morrill reported a bill to the House on April 14, 1864, which eliminated the 1862 Act's progressive rates and proposed a 5% tax on all incomes above $600,[163] some suggest he was acting out of deference to the nation's wealthy private creditors.[164]

At the same time, however, prices were rising, primarily because of the internal revenue measures in the 1862 Act.[165] In fact, prices rose an average of 117% during the war, while money wages rose only 43%.[166] Moreover, the proposed bill sought to double many of the internal revenue rates while increasing the general ad valorem tax from 3% to 5%.[167] Thus, with the compensatory rationale for graduated rates still viable, Augustus Frank, a Republican railroad director from upstate New York,[168] proposed an amendment to the bill providing for a 5% tax on incomes above $600, a 7.5% tax on incomes between $10,000 and $25,000, and a 10% tax on incomes over $25,000.[169] Frank argued that these graduated rates, rather than upsetting the private creditors, would actually please them: "the larger the tax we pay at this time the safer we are and the better will be the securities of the Government."[170] Frank's proposal, however, sparked a debate over the propriety of graduated rates.

Thaddeus Stevens, while supporting the 1862 Act's rates as a political compromise, lashed out at Frank's amendment.[171] Stevens argued:

> It seems to me that it is a strange way to punish men because they are rich. I do not know but there ought to be an indictment against every man who ventures to go above $600 in income . . . . If any

159. CONG. GLOBE, 37th Cong., 2d Sess. 2350 (1862).
160. STANLEY, *supra* note 22, at 31.
161. PAUL, *supra* note 84, at 11; RATNER, *supra* note 108, at 82.
162. STANLEY, *supra* note 22, at 31.
163. RATNER, *supra* note 108, at 82.
164. *See* STANLEY, *supra* note 22, at 33.
165. *Id.* The consumer price index, with a value of 100 assigned to the year 1860, rose on all items from 101 in 1861 to 113 in 1862, and to 139 in 1863. HISTORICAL STATISTICS, *supra* note 157, at 212.
166. ASHLEY, *supra* note 85, at 181.
167. RATNER, *supra* note 108, at 82 n.9.
168. *Id.* at 83.
169. CONG. GLOBE, 38th Cong., 1st Sess. 1876 (1864).
170. *Id.*
171. *See id.*

> man dare go above a certain amount, more than I am worth or any other member, then we should take it all."[172]

Others argued for levying a flat tax at a higher rate rather than preserving the inequality which spurred the wealthy to evade the 1862 tax and resent the war effort.[173]

Several members of Congress advanced theories in favor of the graduated rates. Representative Rufus P. Spalding (R-Ohio) invoked a form of the sacrifice theory in favor of Frank's amendment, arguing that the $600 exemption would allow everyone to pay for necessities, leaving the tax to operate only on the purchase of luxuries.[174] The sacrifice theory's weakness, however, was exposed by Representative John A. Griswold (R-N.Y.), who asked Spalding "[are there not] a vast number of men who are richer on an income of $1,000 than others who have eight or ten thousand?"[175]

Perhaps more compelling was the use of the compensatory theory. Representative Henry L. Dawes of Massachusetts[176] responded to Stevens by denying that it was a punishment to ask the wealthy to pay their fair share, asking Stevens whether he thought "that the poor should pay the taxes for the rich?"[177] Iowa Republican J.B. Grinnell concurred and further proposed that the 10% tax be broadened to apply to incomes of $10,000.[178] Although Grinnell's wartime justification for the rates is sometimes used by observers to dismiss the whole episode,[179] the principle he actually relied upon was a "patriotic" version of the compensatory theory. Grinnell stated:

> I say, that a man who has an income of over ten thousand dollars should be required to live out of that income in time of war, and not be able to lay aside more than ninety per cent. of his income and to pay only ten per cent. of it to the Government, is only reasonable. They do not contribute to the Government a proportion anything like that paid by those who are worth a less sum of money who have gone into our Army.

---

172. *Id.* For similar expressions in the House, see *id.* at 1877, 1940 (statements of Rep. Hubbard (R-Conn.) and Rep. Justin Morrill (R-Vt.), respectively).

173. *See id.* at 1876, 1877 (statements of Rep. Justin Morrill (R-Vt.) and Rep. John Griswold (D-N.Y.) with Rep. Hubbard (R-Conn.), respectively). Representative Hubbard argued that a flat rate of 8% on all incomes exceeding $600 would be preferable to a graduated system. *Id.* at 1877. The returns of the 1862 Act fell far short of the $85,456,000 projected by Chase, amounting instead to only $37,640,000. RATNER, *supra* note 108, at 82.

174. CONG. GLOBE, 38th Cong., 1st Sess. 1877 (1864); RATNER, *supra* note 108, at 84.

175. CONG. GLOBE, 38th Cong., 1st Sess. 1877 (1864).

176. RATNER, *supra* note 108, at 83.

177. CONG. GLOBE, 38th Cong., 1st Sess. 1876 (1864).

178. *Id.*

179. *See* PAUL, *supra* note 84, at 714; Frank W. Hackett, *The Constitutionality of the Graduated Income Tax Law*, 25 YALE L.J. 428, 442 (1916); Patrick E. Hobbs, *Entity Classification: The One Hundred-Year Debate*, 44 CATH. U. L. REV. 437, 442 (1995); Roberts & Stratton, *supra* note 131, at 38. In the debates over later income tax proposals, opponents often argued that the exigency of war justified the Civil War experience. *See, e.g.*, 50 CONG. REC. 3839 (1913) (statement of Sen. Lodge) (R-Mass.); 26 CONG. REC. 1599-1600 (statement of Rep. Ray) (R-N.Y.), 1730 (statement of Rep. Grosvenor) (R-Ohio), 6694 (statement of Sen. Sherman) (R-Ohio) (1894).

> . . . To equalize burdens and mete equal justice is the purpose of my amendment.[180]

Although Grinnell was referring in part to consumption taxes, implicit in his argument was that the poor's personal contribution to the defense of the Union had gone unmatched by many of the wealthy.[181] Thus, "in view of the certain tariff increases and impending direct tax debate," Frank's amendment passed the House and was sent to the Senate.[182]

The Senate revived the debate over graduated rates. As in the House, however, "supporters tended to portray the tax as a balance wheel in the context of a predominantly regressive system, while opponents located inequities in the income tax law itself."[183] Initially, Senator Fessenden announced on May 27, 1864 that the Senate Finance Committee had modified the House bill, striking out the 10% rate and leaving it at 7.5% on all incomes exceeding $10,000.[184] Republican Senator Lyman Trumbull of Illinois, while arguing that even the highest rate should be preserved, offered this defense of progression:

> [B]y the terms of this bill the poor man often pays as much tax as the rich man. He pays upon all the articles which he consumes. A man in this country worth $5,000, who is living comfortably and who has an income perhaps of six hundred or one thousand dollars a year, has as many mouths to feed, as many members in his family to clothe and to shoe and to furnish with all the necessaries of life, as the man who has an income of $500,000 a year; and he pays just as much tax on his sugar and his tea and his meats and everything which he buys. That is not equal; that is, it is not according to the property of the individual. To make this up to some extent we propose by this bill to put a tax upon income.[185]

When Republican Senator John Sherman of Ohio protested that graduated rates imposed a "different rule of taxation" on the wealthy, Trumbull asked "if he does not regard it as applying a different rule of taxation when the poor man pays just as high taxes on all articles he consumes under this bill as a rich man."[186]

Some attacked the principle of progression altogether, arguing that a flat or proportionate rate even as high as 10% would be preferable to the proposed "discrimination" in the rates.[187] Senator Solomon Foot (R-Vt.) pointed out

---

180. CONG. GLOBE, 38th Cong., 1st Sess. 1876-77 (1864).

181. For example, Garrett Davis of Kentucky, a soldier during the war, asked, "Will any gentleman point to me a single millionaire or a man in the United States whose income is above $25,000 that has gone to the field?" *Id.* at 2515.

182. STANLEY, *supra* note 22, at 33.

183. *Id.* at 34.

184. CONG. GLOBE, 38th Cong., 1st Sess. 2513 (1864).

185. *Id.*

186. *Id.* at 2514.

187. *Id.* (statements of Sen. Sherman (R-Ohio), Sen. Foot (R-Vt.), and Sen. Johnson (D-Md.)).

that such a uniform rate would tax people according to their "ability to pay."[188] Foot further stated:

> Under such a rule the man of large estate, having a large income, pays a larger tax or impost than the man of less estate and less taxable income, just in the exact proportion that his assessed income is larger than that of the man of less estate. In this case the burden falls upon the two in the exact proportion to the relative amount of their respective incomes. We ought to ask no more or no less.[189]

Senator Reverdy Johnson, a moderate Democrat from Maryland explained that "the question now is not whether [a wealthy man] is to pay more income tax because he is rich, but whether he is to pay a great deal more by increasing the rate by which you tax the income of the poor man."[190] Thus, while Trumbull's argument supported a proportional income tax of some kind, it did not necessarily require a graduated one.

Radical Republican Massachusetts Senator Charles Sumner, although nominally aligned with Trumbull against Fessenden's proposed amendment, attempted to rebuild the case on different grounds. Sumner cited the sacrifice rationale espoused by French economist J.B. Say to justify the House bill's steeply graduated rates.[191] According to Sumner, Say, in reliance in part upon the works of Adam Smith, wrote, "If a person had to pay 200f. more in taxes upon every addition of 1,000f. to his revenue, still he would multiply his enjoyments in a larger ratio than his sacrifices."[192]

The end result in favor of graduation, though, appeared to be reached under something closer to the compensatory rationale. Initially, Fessenden's amendment for lower graduated rates passed, despite Kentucky Unionist Garrett Davis' fervent support of Sumner's argument.[193] The next day, however, a proposal to levy the highest tariff rates of the war passed in the House.[194] Furthermore, during the interval in the Senate, Radical Republican James W. Grimes of Iowa "succeeded in getting the Senate to suspend indefinitely the operation of the direct tax" slated to be collected in 1865 under the House bill.[195] These two developments served both to increase the burden on poor consumers and ease the burden on wealthy landowners. It also created a definite shortfall in the revenue bill. Thus, on June 6, 1864, the Senate reversed gears and approved, first, an amendment by Senator James F. Wilson of Iowa for a 7.5% tax on all incomes over $5,000 and second, an amendment

---

188. *Id.*
189. *Id.* (statement of Sen. Foot).
190. *Id.*
191. *See id.* at 2514-15.
192. *Id.* at 2515.
193. *See id.* The amendment to the House bill was passed 22 to 15 with 12 senators absent. *Id.* Sumner joined the majority, recognizing that "such a tax would probably produce comparatively little, and I am sure in certain quarters would be odious." *Id.* at 2513, 2515.
194. STANLEY, *supra* note 22, at 34; *see* CONG. GLOBE, 38th Cong., 1st Sess. 2751 (1864). The bill raised the average rate on dutiable commodities from the 37.2% level imposed in 1862 to 47.02%. RATNER, *supra* note 108, at 88.
195. RATNER, *supra* note 108, at 85.

by Senator Grimes for a 10% tax on all incomes over $15,000.[196] Although Grimes attributed this development to the impact made on the Senators by Sumner's May 27 speech,[197] this conclusion seems doubtful given the Senate's rejection of the higher graduated rates at that time. Rather, it was more likely Wilson's two rationales—to make up for lost revenues and to broaden the tax burdens—that swayed the Senate.[198] Even Grimes relied in part upon a general compensatory rationale in responding to Missouri Unionist Senator John B. Henderson's criticism of his proposal. In this repect, Grimes stated, "If there is any class of men that the distinction ought to be made in favor of and not against it is the very class of men we have discriminated against [in other ways]."[199] The bill was sent to the Committee of the Conference where it emerged with an even more steeply graduated rate of 10% on incomes above $10,000.[200]

Although the 1864 Act produced the highest revenue collections from income taxes during the War,[201] the Treasury continued to struggle.[202] Secretary Chase failed to properly market the government bonds and, somewhat unexpectedly, Lincoln accepted his resignation.[203] After appointing former Senate Finance Committee chair William Pitt Fessenden as the new Treasury Secretary, things picked up a bit.[204] Fessenden, however, recommended in a report issued in December 1864 that more revenue was necessary to continue prosecuting the war effort.[205] Thus, on February 9, 1865, Justin Morrill introduced a bill to amend the 1864 Act by increasing the tax from 7.5% to 10% on incomes over $3,000.[206] The House rejected Illinois Democrat Lewis W. Ross' proposal for a radically progressive income tax, which set the highest rate at 20% on incomes over $20,000. It settled instead on a moderate solution offered by Kentucky Unionist Robert Mallory which raised the tax to 10% on incomes over $5,000.[207] With minor modifications, Congress adopted this proposal in the final version of this amendment to the 1864 Act.[208] The Act was later challenged before the Supreme Court in *Springer v. United*

196. CONG. GLOBE, 38th Cong., 1st Sess. 2759 (1864).
197. *Id.* at 2760.
198. *Id.* at 2759.
199. *Id.* at 2760.
200. Act of June 30, 1864, ch. 173, 13 Stat. 223, 281 (repealed 1933); RATNER, *supra* note 108, at 85. A few days later, after Secretary Chase realized that an unanticipated shortfall would develop over bounties promised to aid in the recruitment and retention of soldiers, Congress passed the Emergency Income Tax Act of July 4, 1864. RATNER, *supra* note 108, at 89. This Act imposed a special flat income tax of 5% on all incomes over $600, assessed on income which accrued in 1863 and as an addition to the 1862 rates. *Id.*; STANLEY, *supra* note 22, at 35.
201. STANLEY, *supra* note 22, at 36.
202. PAUL, *supra* note 84, at 14.
203. *Id.*
204. *Id.*
205. RATNER, *supra* note 108, at 96.
206. *Id.* at 97.
207. *Id.* at 97-98.
208. *See* Act of Mar. 3, 1865, ch. 78, 13 Stat. 469, 479; CONG. GLOBE, 38th Cong., 2d Sess. 1293 (1865).

States,[209] but its provisions were upheld without discussing the Act's graduated feature.[210]

By 1866, with the war over, the political compromise that previously had supported a graduated income tax began to unravel.[211] Although the country was left with an enormous debt and significant reconstruction expenses, the war tax system as a whole became a "fearful weight."[212] Frederick A. Pike of Maine remarked in a House floor debate that they had received "petitions from struggling manufacturers . . . from all quarters of the land, asking for relief."[213] Political economist David Wells, the recently appointed Special Commissioner of the Revenue, issued a report in 1866 which found that high prices were the chief cause of postwar stagnation.[214] Hence, Wells' report recommended to Treasury Secretary Hugh R. McCulloch that they lower these prices by effecting a wholesale reduction in national taxation, beginning with internal revenues and tariffs.[215] The graduated income tax, although now derided by many, was still not ready for modification.

When Justin Morrill attempted, as he had in 1864, to introduce an income tax bill which eliminated the graduated income tax and imposed a flat 5% rate on incomes over $1,000, his measure was soundly defeated.[216] Representative Pike noted that until achievement of a reduction in prices, such a measure must wait:

> Every laboring man in the country pays a tax upon what he eats, drinks, and wears. And until we come to the point of relieving the great body of people in the country from onerous taxes upon everyday's consumption it is a question whether or not the men who are able to pay should not pay this increased proportion of their income to the General Government.[217]

Pike instead proposed a tax of 5% on incomes exceeding $1,000 and 10% on incomes exceeding $5,000.[218] Morrill, a fierce abolitionist and a founder of the Republican Party,[219] responded to this logic by invoking the mantra of

---

209. 102 U.S. 586 (1880).

210. The Court held that the tax was more akin to a duty or an excise than a direct tax such as property or capitation tax. *Springer*, 102 U.S. at 602. Thus, the tax was properly not apportioned. *See id.*

211. PAUL, *supra* note 84, at 23.

212. *Id.*

213. CONG. GLOBE, 39th Cong., 1st Sess. 2783 (1866). Pike was specifically referring to the "many small and weak manufacturers of the country," who were hurt by tariffs on raw materials. *Id.*

214. STANLEY, *supra* note 22, at 44.

215. *Id.* The wholesale price index, with a value of 100 assigned to the years 1910-14, indicated a value of 193 in 1864 and 185 in 1865, after a pre-war low of 89 in 1861. HISTORICAL STATISTICS, *supra* note 157, at 201. Perhaps even more revealing, the Federal Reserve Bank of New York's cost-of-living index, with a value of 100 assigned to the year 1913, had climbed from 63 in 1861, to 102 in 1865, to 103 in 1866, and to 102 in 1867. *Id.* at 212. Burgess's cost-of-living index revealed a similar pattern on the same scale, with a 61.2 in 1861, up to a 108.1 in 1865. *Id.*

216. RATNER, *supra* note 108, at 113.

217. CONG. GLOBE, 39th Cong., 1st Sess. 2783 (1866).

218. RATNER, *supra* note 108, at 113.

219. *Id.* at 65.

racial equality, the subject of much attention in recent months: "In this country we neither create nor tolerate any distinction of rank, race, or color, and should not tolerate anything else than entire equality in our taxation."[220] He went too far, however, when he compared the defense of a steeply graduated tax proposed by Representative Ross to "the same ground that the highwayman defends his acts."[221] Morrill's comparison attracted the ire of a number of representatives,[222] and although Morrill admitted that he may have expressed himself "a little too strongly," he argued that because "[o]ur urgent necessities during the war hav[e] ceased, I think we ought to relieve ourselves at the earliest moment from such a tax."[223] Despite having allies in this view,[224] they generally misunderstood that the majority view, as opposed to Ross' radicalism, was not that the wealthy should endure an inequality, but rather that they should not receive an exemption. To the extent that an inequality existed, it compensated for the inequality of other forms of taxation which resulted from the "necessities" of war and caused higher prices. Representative Ithamar C. Sloan, a Wisconsin Republican who later served as the dean of the law department at the University of Wisconsin, pointed out Morrill's inability, or lack of political desire, to see the bigger picture:

> Now, throughout consideration of this bill the chairman of the Committee of Ways and Means [Morrill] has resisted strenuously all propositions to relieve from taxation many articles the tax upon which is oppressive and burdensome to the industry of the country. The tax upon those articles tends to depress and check the business and enterprise of the country.[225]

Sidney Ratner likewise concluded, "The House majority felt that the poorer classes bore many small but burdensome taxes which ought to be reduced or removed before the more wealthy classes received relief."[226] After the House passed Pike's proposal,[227] it sent the Bill to the Senate, which adopted it without much debate or modification. In fact, the Senate's sole modification was to lower the exemption to $600.[228]

Because the final act declared the income tax payable every year until and including 1870,[229] Morrill needed only to bide his time. Indeed, his argument did not fall upon deaf ears, for less than a year later Congress swung around to Morrill's position. Sensing this change, Morrill again presented, on Febru-

---

220. CONG. GLOBE, 39th Cong., 1st Sess. 2783 (1866).

221. *Id.* Ross's views on the progressive income tax, largely based on a sacrifice or redistributive rationale, were not widely shared. As in 1865, Ross proposed a graduated tax with a high rate of 25% on incomes in excess of $60,000. *Id.*

222. *See id.* at 2784 (statements of Rep. Spalding (R-Ohio), Rep. Sloan (R-Wis.), and Rep. Paine (R-Wis.)).

223. *Id.*

224. *See id.* (statement of Rep. Price) (R-Iowa), and at 2785 (statements of Rep. Davis (R-N.Y.) and Rep. Hale (R-N.Y.)).

225. *Id.* at 2784.

226. RATNER, *supra* note 108, at 113.

227. CONG. GLOBE, 39th Cong., 1st Sess. 2786 (1866).

228. *See* RATNER, *supra* note 108, at 114.

229. *Id.*

ary 13, 1867, a revenue bill to the House which proposed the imposition of a flat, rather than graduated, tax of 5% on incomes over $1,000.[230] In presenting this proposal, Morrill argued:

> Few nations tolerate an income tax at all, and there is no nation which has any other than a uniform rate. The Treasury needs money; but on a question of taxation justice must be dealt out with an even hand, and the rule of perfect equality should be immovable as the poles.[231]

By this time, the reductions in internal taxes in 1866 and in the proposed bill, coupled with the first of many years of federal budget surpluses,[232] made the graduated income tax ripe for Morrill's attack. Thus, the House defeated, by a vote of 73 to 26, Illinois Republican Representative Jehu Baker's[233] proposal to amend the bill to add 10% tax on incomes over $6,000.[234] As Pennsylvania Representative George F. Miller explained, "The tax upon incomes for the last two years has yielded more revenue to the Government than the tax upon anything else. . . . [M]en [in the great cities] have made very fair and honest returns of their incomes, and from that source has come an enormous sum for our Treasury."[235] The inaccuracy of Miller's statement does not detract from its reflection of his desire to justify the end of graduation by suggesting the end of the need to compensate for regressive taxes.[236] In any event, repealing the graduation feature while retaining the income tax itself was a recognition of the high consumer prices.[237] As a political matter, however, and much like the state income taxes which followed the same pattern,[238] Congress could

---

230. CONG. GLOBE, 39th Cong., 2d Sess. 1218 (1867).

231. *Id.*

232. *See* RATNER ET AL., *supra* note 70, at 346. The bill proposed to reduce the excise taxes on 51 goods, including such necessaries as "clothing," "salt," and "sugar," for a total savings of $36,730,500 after some additional across-the-board cuts. CONG. GLOBE, 39th Cong., 2d Sess. 1218 (1867) (statement of Rep. Morrill) (R-Vt.).

233. RATNER, *supra* note 108, at 115.

234. CONG. GLOBE, 39th Cong., 2d Sess. 1482-83 (1867). The House also rejected two somewhat more moderate graduated income tax proposals from Rep. Ralph Hill (R-Ind.) and Rep. Pike (R-Me.). *Id.* at 1483.

235. *Id.*

236. Paul reports that 1866 was indeed the income tax's greatest year in terms of revenue production, totalling $73 million. PAUL, *supra* note 84, at 29. The income tax, which paid only 10% of total expenditures in 1862, amounted to 25% in 1864 and 1865. *Id.* However, it still paled in comparison with the "$180 million in customs receipts and $236 million from other internal revenue sources." *Id.* Perhaps searching for another rationale, future President James A. Garfield of Ohio argued for a flat tax on constitutional grounds instead. CONG. GLOBE, 39th Cong., 2d Sess. 1482 (1867). This rationale, unlike the compensatory theory, was openly contested. *See id.* at 1483 (statement of Rep. Hill) (R-Ind.).

237. The Federal Reserve Bank of New York's cost-of-living index was still at 102 in 1867, but dropped to 91 in 1870. HISTORICAL STATISTICS, *supra* note 157, at 212.

238. Income taxes in several states, including Virginia, North Carolina, Georgia, and Texas, were graduated for a brief period during or after the Civil War. *See* SELIGMAN, *supra* note 30, at 406-14. In all such cases, the rates were eventually made proportional again or the tax was abandoned completely. *See id.* For example, Virginia and North Carolina both imposed a graduated tax in 1866, but the states returned to a flat tax in 1870 and 1869 respectively. *See id.* Seligman suggested that this trend occurred in the South because

> [p]ractically none of [the southern states] had developed the system of the general property tax as it was found in the North, and it was felt to be entirely out of the question to expect that the burdens of the impending conflict should be borne entirely by owners of

no longer justify the graduation in the income tax by suggesting that the wealthy were almost completely exempt from taxation.[239]

As 1870, the date set for the expiration of the income tax, approached, anti-income tax sentiment grew. The *New York Tribune* succinctly stated on February 5, 1869, that "'[t]he [i]ncome [t]ax is the most odious, vexatious, inquisitorial, and unequal of all our taxes.'"[240] Congress started receiving petitions in opposition to the renewal of the tax in early 1870 from such diverse sources as the Boards of Trade of Buffalo and Cleveland, the California legislature, and the Union League Club of New York City.[241] In addition, citizens of New York City and Philadelphia organized anti-income tax associations, and papers from San Francisco, California to Erie, Pennsylvania voiced their opposition.[242] The advent of the first period of economic prosperity since the war[243] added to the movement against the income tax. Wholesale prices, which had been falling in small increments each year since 1864, experienced a drop between 1869 and 1870 which was more than double the decline from the previous year.[244] Sugar, for example, which had been 16 cents/lb. in 1868 and 1869, fell to 13.5 cents/lb. in 1870.[245] Wheat, which had been $2.541 a bushel in 1868, decreased to only $1.373 a bushel in 1870.[246] At the same time, the gross national debt had been reduced by more than $300 million since 1866 and the per capita debt dropped more than 18%.[247] The continued high taxes, coupled with the general prosperity, thus allowed the government to amass budget surpluses which were used to draw down the national debt.[248] While public sentiment supported this for awhile, the tide had turned so that, according to Senator John Sherman, the new slogan was "[s]top paying the national debt and throw off taxes."[249]

---

real estate and slaves.

Id. at 406.

239. This was certainly more than just a mere battle of conscience, though, as Randolph Paul noted: the banking and manufacturing interests fought vigorously against the merchants and importers for the reduction of the income tax. PAUL, *supra* note 84, at 27. Indeed, the Radical Republicans won significant majorities in both houses of Congress in the 1866 elections, and the price for some of their social causes was an alliance with the industrial sector on economic issues. RATNER, *supra* note 108, at 114-15. As is sometimes true, however, the political strength of a lobby rises with the popular force of its position. *See* WITTE, *supra* note 79, at 285-88. In this case, Congress could respond to the "plight of the wealthy" only when the war ended and the burden on the masses was lifted.

240. RATNER, *supra* note 108, at 122 (quoting the *New York Tribune*, Feb. 5, 1869).

241. STANLEY, *supra* note 22, at 45.

242. *Id.*

243. *Id.* at 54.

244. *See* HISTORICAL STATISTICS, *supra* note 157, at 201.

245. *Id.* at 209.

246. *Id.* Of course, much of this immediate price decline was due more to the post-war policy of monetary contraction, an attempt to make paper dollars convertible one-for-one into specie instead of the fifty cent premium on gold over the paper dollar, rather than the reduction in consumption taxes. RATNER ET AL., *supra* note 70, at 355. This economic reality does not negate the compensatory theory rhetoric or its vision of the understanding of equality in taxation.

247. *See* RATNER, *supra* note 108, at 123 ("The total gross debt was reduced from $2,755 million in 1866 to $2,430 million in 1870, and the per capita debt was lowered from $77 in 1866 to $63 in 1870.").

248. *See id.*

249. CONG. GLOBE, 41st Cong., 2d Sess. 4714 (1870). Senator Henry W. Corbett (R-Or.),

Despite this political and economic groundswell, an interesting alliance developed to temporarily forestall the complete repeal of the income tax. Domestic manufacturers and agricultural producers, flush with the recent economic prosperity, sought a return to explicitly protective tariffs.[250] Thus, early in 1870, the Ways and Means Committee submitted a tariff bill which made reductions almost exclusively in "purely revenue articles," while effecting a significant increase in duties on "protected articles."[251] Debate over the bill, however, was deadlocked.[252] Although "the proposed tariff bill pretended" to "satisfy the pressure for reduction in taxes," it was not enough.[253] A bill was introduced to lower internal taxes while maintaining the income tax essentially at its prior level.[254] Apparently, the pro-tariff forces aligned with the pro-income tax forces to effectuate this move. According to Robert Stanley's study of the roll call votes in Congress on the two issues, 94 of the 154 voting delegates, or two-thirds of those voting, supported both the income tax bill and the tariff bill.[255] Stanley argues this refutes the progressive model that pits the urban, Northeastern Republicans against the rural agrarians on these issues.[256] According to Stanley, this is proof of the "centrist" designs of the establishment.[257] The results, however, are not surprising in a Congress operating under notions of equality informed by the compensatory theory.

A call to reduce taxes, just as in a demand to raise them, could be accomplished through an infinite number of variations involving excise taxes, tariffs, and income taxes. Congress was wary of tipping the scale too far in one direction. Thus, Representative Austin Blair (R-Mich.) reminded Congress that "every dollar which we take off this income tax, which applies to the rich men of the country, must be laid upon the poorer men of the country."[258] Representative Eugene M. Wilson (D-Minn.), echoing this sentiment, argued that for every dollar lost because the income tax was reduced, "we are prevented from

---

arguing a proposition with which many contemporary politicians might agree, asked:

> Why should we attempt to pay off the entire debt within our generation? The system of Alexander Hamilton, to pay off a debt within the generation by which it was created, may have been wise in those days, when our income was very limited and population small; but with a country increasing so rapidly in population as ours, with people coming from all portions of the globe, settling in the United States and taking up our public lands, given them as a gratuity, and who will eventually, by reason of taking these lands, become comparatively wealthy, why not provide for those people paying a portion of the tax necessary to discharge the debt?

Id. at 4718.

250. *See* STANLEY, *supra* note 22, at 45-46.

251. RATNER, *supra* note 108, at 123-24. Duties often distinguished between "purely revenue articles," for which there was no significant domestic competition and the principal reason for imposing a duty was to raise revenue, and "protected articles," which were designed to raise the costs of a foreign good, so as to protect the domestic manufacturers of the same good from outside competition. *Id.*; *see also* BENDER'S FEDERAL REVENUE LAW 356 (Matthew Bender & Co., 1917).

252. STANLEY, *supra* note 22, at 46.

253. RATNER, *supra* note 108, at 124.

254. *Id.*

255. STANLEY, *supra* note 22, at 51.

256. *See id.*

257. *See id.* at 51-53. Stanley uses this term in a pejorative sense to describe all efforts to preserve the status quo.

258. CONG. GLOBE, 41st Cong., 2d Sess. 3994 (1870).

seeking lower tariff duties."[259] Perhaps recognizing this zero-sum game, pro-tariff domestic manufacturers viewed the maintenance of some form of income tax as preferable to the continued existence of heavy internal duties on their products.[260] This frustrated Democrat Stevenson Archer of Maryland, who decided to oppose the income tax "[b]ecause it is to be kept up for the benefit of manufacturers and high tariff men, who control large bodies of voters, maintaining this burden in order to remove more special taxes from their shoulders."[261]

After the House passed an income tax of 3% on incomes in excess of $2,000 as a companion to the tariff bill, a similar discussion was held in the Senate.[262] Senator John Sherman of Ohio, chair of the Senate Finance Committee, led the tariff/income tax alliance against the other internal tax forces. Recognizing the popular demand for a reduction of taxes, he noted, "The real question is, what taxes ought to be repealed [and] which among them bear most upon the industry of our people?"[263] Sherman advocated retaining the tariff and the income tax, while Congress focused its attention on reducing internal taxes.[264] Although the internal taxes and the customs duties both impacted consumption, Sherman distinguished them, arguing that the customs duties "are indirect."[265] In this respect, Sherman stated, "They are mainly upon articles of luxury or consumption, so well distributed that the taxes fall fairly and in just proportion to ability to pay . . . they are as well distributed as any taxation on consumption can be."[266] He argued that because any tax on consumption "is in its nature an unequal tax," an income tax was necessary to compensate for the unequal burden.[267] Some countered Sherman's assertion by noting that the income tax instituted its own inequality even with a flat rate as it contained an exemption for those earning less than $1,000.[268] Sherman responded with a clear invocation of the compensatory theory's logic:

> You may, therefore, properly exempt the great mass of the people, but solely on the ground that their tax on the articles consumed by them is more than any income tax that could possibly be laid on the rich.
>
> Take the ordinary consumption of tea, sugar, and coffee . . . . If the ordinary quantity of these three articles is consumed, the duty on them alone for a man whose income is derived from his daily labor is more than the highest income tax that has ever been levied in the United States; and therefore this exemption in favor of the great mass

259. *Id.* at 4023.
260. *See id.* (statement of Rep. Wilson) (D-Minn.).
261. *Id.* at 4033.
262. *See id.* at 4063-64.
263. *Id.* app. at 377.
264. *Id.* app. at 377-78.
265. *Id.* app. at 377.
266. *Id.*
267. *Id.* app. at 379.
268. *See id.* at 4714 (statement of Sen. Henry Winslow Corbett) (R-Or.).

> of the people of $1,000 . . . is exempted on the ground that they already, in other ways, pay a larger tax.[269]

Sherman's threat to either restore the so-called "special taxes" and "gross receipts taxes," or strike out those sections of the tariff bill which repealed revenue tariffs if the income tax was not renewed,[270] perhaps ultimately persuaded some members of Congress. Thus, pro-tariff and anti-special tax forces compromised with income tax supporters to retain the income tax, albeit at the low rate of 2% and with a short lifespan of only two years.[271]

Despite this minor setback, income tax opponents continued their attempt to repeal the tax during the years 1871 and 1872. They voiced the criticisms which had been circulating for a decade: It was inquisitorial because it invaded a man's private finances; it encouraged perjury; it was a war tax which had outlived its usefulness; it was too expensive to collect; it was unnecessary because of surpluses; it was unconstitutional because it was unapportioned; and it was discriminatory and unequal.[272] Income tax supporters attempted to demonstrate that these criticisms could be levied on any form of tax, but to no avail. As John Rice of Kentucky admitted, "[T]he question of revenue reform and reduction of taxation is engrossing more of the attention of the people than any other with which this Congress has to deal."[273] This time, however, the argument that the popular clamor was for a reduction in consumption taxes, not a reduction in income taxes, went unheeded.[274]

The economy further improved during the early 1870s. The business failure rate dropped to between one-quarter and one-third of its rate during the panic year of 1857 and stood at its lowest point until after World War I.[275] As a consequence, budget surpluses remained high. In fact, from 1870 to 1872, the surpluses were around $100 million, five times higher than the highest antebellum figure in 1836.[276] With prices on noncompeting goods continuing their free-fall,[277] the pressure to equalize the burdens of the regressive consumption taxes no longer carried much weight. Sherman felt that these days of giddy prosperity would soon pass, at which time the public would again demand a compensatory income tax:

> It will not do to say that each person consumes in proportion to his means. This is not true. Every one must see that the consumption of the rich does not bear the same relation to the consumption of the poor as the income of the one does to the wages of the other.

---

269. *Id.*
270. *Id.* at 4716.
271. RATNER, *supra* note 108, at 126-27.
272. *See, e.g.*, CONG. GLOBE, 42d Cong., 2d Sess. 1735 (1872) (statement of Rep. Rice) (D-Ky.) (cataloging the criticisms of income tax opponents); CONG. GLOBE, 41st Cong., 3d Sess. 720 (1871) (statement of Sen. John Scott) (R-Pa.).
273. CONG. GLOBE, 42d Cong., 2d Sess. 1734 (1872).
274. *See id.* at 1737.
275. STANLEY, *supra* note 22, at 54.
276. STANLEY, *supra* note 22, at 284 n.105 (citing HISTORICAL STATISTICS, *supra* note 157, at Series Y 254-57).
277. *See id.* at 201. The consumer price index dropped from 141 in 1870 to 135 in 1872. *Id.* at 212.

> As wealth accumulates, this injustice in the fundamental basis of our system will be felt and forced upon the attention of Congress. Then an income tax, carefully adjusted, with proper discriminations between income from property and income from personal services, and freed from the espionage of our present law, will become a part of our system.[278]

Certainly, generous "contributions" to political campaigns during the 1872 campaign, later exposed in the Credit Mobilier scandal, helped grease the skids on the income tax's exit.[279] But these elements, just as the arguments against the income tax, were present before. The conditions under which the income tax was allowed to expire are what is significant. During the political campaign, pro-tariff supporters secured a "consumer-oriented" tariff bill which further reduced revenue tariffs and even dropped protective tariffs 10%, leading to the campaign promise of a "free breakfast table."[280] Coupled with the falling prices and rising wages, Congress perceived (or at least hoped that the public perceived) that it no longer needed to balance out the regressive effects of the tariff and other consumption taxes. While this may not have been precisely true, it illustrates that the income tax, and its graduation, was a function of the need to portray a flat or proportionate distribution of overall tax burdens, not a progressive one. Some radical supporters of the income tax wanted to equalize incomes rather than just rates. Some opponents failed to comprehend how the income tax compensated for the regressive consumption taxes. On balance, however, the graduated income tax during the Civil War and Reconstruction was viewed as part of a flat-tax based revenue scheme.[281] When the obscene inequity of the exclusive reliance on tariff taxes became less noticeable, the system appeared to be flat once again and the need for the income tax as a counterweight had passed.

C. *The Income Tax of 1894*

The income tax issue continued to simmer during the 1870s and 1880s,[282] but a number of influences converged to make it a reality in 1894.

---

278. CONG. GLOBE, 42d Cong., 2d Sess. 1708 (1872).

279. RATNER, *supra* note 108, at 135.

280. *Id.*; STANLEY, *supra* note 22, at 55; *see also* BENDER'S FEDERAL REVENUE LAW, *supra* note 85, at 356 ("Duties were removed from revenue producers, and political influences growing out of the war were able to maintain the high protective policy."). One author noted:

> Whilst apparently a concession to Free Trade, the new Act really strengthened the position of Protection; its authors had gratified the general desire for a reduction of taxation, but they had done this particularly in regard to internal duties and what may be called 'breakfast-table taxes'; and consequently, as in 1870, they had made the country still more dependent for Federal revenue upon the purely protective duties.

ASHLEY, *supra* note 85, at 188.

281. Indeed, the income tax was not unique as a compensatory tool. Sherman pointed out, "During the war, these [customs] duties were increased to counterbalance the internal taxes levied upon domestic industry." CONG. GLOBE, 42d Cong., 2d Sess. 1709 (1872).

282. WITTE, *supra* note 79, at 70. Fourteen different income tax bills were introduced into Congress between 1873 and 1879. FRIEDMAN, *supra* note 108, at 565. Tennessee Representative Benton McMillin introduced bills to reinstitute an income tax from 1879 through the early 1890s.

Great fortunes were amassed during the high prosperity and high protectionism of the 1880s.[283] This focused attention back to the inequities of the tariff system during the election of Democrat and former President Grover Cleveland in 1892.[284] Coupled with popular unrest and economic dislocation engendered by the panic and depression of 1893,[285] conditions justified another attempt at an income tax. Although the income tax adopted rested upon compensatory theory, the tax itself was flat, rather than graduated.[286]

The high protective tariffs enacted at the end of Reconstruction essentially remained intact through the beginning of the 1890s.[287] The sustained period of economic growth during the 1880s strengthened this practice, which was justified on the ground that it benefitted industry and raised wages.[288] Not only did this prosperity create annual surpluses of over $100 million,[289] but it also permitted the cost-of-living to remain relatively low during the period.[290] The tariff began to show signs of weakness, however, during the 1888 election campaign. Grover Cleveland, searching for an issue to galvanize supporters after an uninspiring first term, broke with precedent and concentrated solely on the tariff issue in his State of the Union address of December 6, 1887.[291] In an attempt to appeal both to farmers desiring to sell in free markets abroad and manufacturers looking to buy cheaper supplies, Cleveland called for general reductions in the protective tariff and free raw materials.[292] According to Cleveland's biographer Allan Nevins, the speech, which newspapers throughout the country reprinted, "'was read as no Presidential messages since Lincoln's had been.'"[293] Frank Taussig, a noted historian of the tariff, commented that Cleveland's message made the tariff question "more distinctly a party matter than it had been at any time since the Civil War."[294] Although Cleveland eventually lost his re-election bid to Republican Benjamin Harrison in 1888,[295] the tariff question did not fade from the political scene. In 1890, the Republicans secured passage of the McKinley Tariff Act, "an out and out protective measure" designed as a monument to the "American System" of industrial development based upon strong protectionism.[296]

RATNER, *supra* note 108, at 172.

283. WITTE, *supra* note 79, at 70.

284. *Id.*

285. *Id.*

286. FRIEDMAN, *supra* note 108, at 565.

287. *See* BENDER'S FEDERAL REVENUE LAW, *supra* note 85, at 356; RATNER ET AL., *supra* note 70, at 389.

288. SELIGMAN, *supra* note 30, at 493.

289. WITTE, *supra* note 79, at 70.

290. HISTORICAL STATISTICS, *supra* note 157, at 212.

291. SPEECHES OF THE AMERICAN PRESIDENTS 263 (Janet Podell & Steven Anzovin eds., 1988); STANLEY, *supra* note 22, at 110.

292. STANLEY, *supra* note 22, at 110. For a discussion of the farmer's shifting interest in the tariff, see SELIGMAN, *supra* note 30, at 494.

293. SPEECHES OF THE AMERICAN PRESIDENTS, *supra* note 291, at 263.

294. F.W. TAUSSIG, THE TARIFF HISTORY OF THE UNITED STATES 253 (8th ed. 1967). According to Percy Ashley, Cleveland "declared uncompromisingly in favour of a very considerable reduction of duties." ASHLEY, *supra* note 85, at 196.

295. STANLEY, *supra* note 22, at 110.

296. BENDER'S FEDERAL REVENUE LAW, *supra* note 85, at 356. The phrase, "American System," was popularized by Henry Clay in the first half of the nineteenth century. JOHN K.

With passage of the McKinley Act, the Republicans erected a lightning rod for a storm of protest against the advantages of accumulated wealth. During the late 1880s and early 1890s, Populism spread as a principally agrarian political entity geared toward "restor[ing] the economic individualism, the political democracy, and the morality of personal responsibility that existed in earlier America."[297] The movement was not an assault against the accumulation of wealth per se, but against the improper advantages assumed by the wealthy. Similar concerns had prompted the passage of the Interstate Commerce Act in 1887, which prohibited railway price-fixing, and the Sherman Anti-Trust Act in 1890, which declared contracts and combinations in restraint of trade illegal.[298] For the farmer, however, the very real consequences of the steady decline in agricultural prices after the Civil War overshadowed these broad concerns.[299] The wholesale price index for farm products fell from 133 in 1867 to 71 in 1890.[300] The farmers themselves attributed this decline to issues of monetary policy,[301] although they felt that the protectionist tariff exacerbated their plight. In fact, the farmers had initially supported protectionism as a boon to their success in domestic markets, but increasingly saw it as inconsistent with American agriculture's movement into the export market: farmers bought supplies and goods in a protected market while selling in a predominantly free market. When coupled with their belief that the tariff benefitted the manufacturers who were propping up the gold standard on Wall Street, the McKinley Tariff Act was an unwelcome sight.[302]

Given this hostility, President Harrison was on the defensive during his first State of the Union address after the passage of the McKinley Act, claiming objections to the Act were based upon "misinformation."[303] The Demo-

---

GALBRAITH, ECONOMICS IN PERSPECTIVE: A CRITICAL HISTORY 157 (1987).

297. Marjorie E. Kornhauser, *The Morality of Money: American Attitudes Toward Wealth and the Income Tax*, 70 IND. L.J. 119, 136 (1994). For a general discussion of the Populist movement, see LAWRENCE GOODWYN, DEMOCRATIC PROMISE: THE POPULIST MOMENT IN AMERICA (1976).

298. GALBRAITH, *supra* note 296, at 161-62. Railroads were particularly subject to criticism for their facilitation of the growth of wealth. *See* Hobbs, *supra* note 179, at 442-43. Families such as the Goulds and Vanderbilts amassed part of their fortunes as a result of this industry. *Id.* This entire movement was also intimately connected to the push for tariff reform, since many viewed the tariff as protecting trusts from competition. *See* Marjorie E. Kornhauser, *Corporate Regulation and the Origins of the Corporate Income Tax*, 66 IND. L.J. 53, 75 n.82 (1990).

299. *See* RATNER ET AL., *supra* note 70, at 267.

300. *Id.*

301. *Id.*; SELIGMAN, *supra* note 30, at 494. The principal difficulty, according to the Populists, was the long-held notion that paper dollars must be supported by some underlying specie such as gold or silver. *See* RATNER ET AL., *supra* note 70, at 353. Price fluctuations in those commodities, rather than the decision of a central government body such as the Federal Reserve Board today, regulated the money supply and the value of money itself. *See id.* As a response to this perceived problem, farmers helped create the "Greenback" party, referring to the color of paper notes issued during the Civil War which were not backed by specie. *See* GOODWYN, *supra* note 297, at 11. Democrats, including William Jennings Bryan, sought a change from the de facto gold standard to allow silver coinage or at least a truly bimetallic standard because of the greater quantity of the latter mineral. *Id.* at 439-42; *see also* RATNER ET AL., *supra* note 70, at 358-61. Advocacy of the silver standard helped propel the Democrats to victory in 1892. SELIGMAN, *supra* note 30, at 495.

302. *See* SELIGMAN, *supra* note 30, at 494.

303. Benjamin Harrison (Dec. 3, 1889), *in* 2 THE STATE OF THE UNION MESSAGES OF THE PRESIDENTS, 1790-1966, at 1668 (Fred L. Israel ed., 1967) [hereinafter UNION MESSAGES].

cratic victory in 1892, returning Cleveland to the White House, was seen by many as a mandate for tariff reform.[304]

Soon after Cleveland's election, the country was thrown into another panic, sparked by the failure of a major railroad company and a drop in the Treasury's gold reserves in April 1893.[305] The ensuing depression was "one of the longest and most severe in history."[306] Gross national product dropped 10% and unemployment rates were as high as 20% with four million jobless.[307] Deflation in the agricultural sector intensified, and farms foreclosed at rates as high as 75% in some western counties.[308] The 1890 treasury surplus of $105 million became a deficit of $70 million in 1894, due in part to the increase in government spending on aid and public works programs.[309] These efforts, however, were insufficient. Labor strife, which had become more prominent during the late 1880s and early 1890s, intensified in tone and force.[310] During the spring and summer of 1894, violence erupted in Pennsylvania, Buffalo, and Cleveland, and culminated in the Pullman strike of June and July 1894. This strike in turn led to a series of bloody confrontations between workers and law enforcement officials.[311] "Coxey's Army," a band of destitute and discontented citizens led by Populist Jacob Coxey of Ohio, symbolized the tension of the times. The "Army," seeking work relief and demanding inflationary monetary policy, took over the grass outside the Capitol building in Washington D.C.[312]

With this inauspicious beginning to his presidency, Cleveland set out to make good on his promise for tariff reform.[313] During the fall of 1893, the House Ways and Means Committee began to explore the issue. Representative

---

304. ASHLEY, *supra* note 85, at 213 ("The causes of the change in public opinion are not very clear; the new tariff had not been sufficiently long in force for any definite opinion to be formed as to its effects; but no one could allege that the issue had not been clearly set before the country."); PAUL, *supra* note 84, at 34; PAUL C. ROBERTS, NAT'L REV., Apr. 17, 1995, at 9; SELIGMAN, *supra* note 30, at 495. In Harrison's State of the Union message after his defeat, he conceded, "The result of the recent election must be accepted as having introduced a new policy. We must assume that the present tariff, constructed upon the lines of protection, is to be repealed and that there is to be substituted for it a tariff law constructed solely with reference to revenue . . . ." Benjamin Harrison (Dec. 6, 1892), in 2 UNION MESSAGES, *supra* note 303, at 1711-12.

305. RATNER ET AL., *supra* note 70, at 360-61; STANLEY, *supra* note 22, at 111 n.22.

306. STANLEY, *supra* note 22, at 111.

307. *Id.*; Barbara B. Woodhouse, *"Who Owns the Child?": Meyer and* Pierce *and the Child As Property*, 33 WM. & MARY L. REV. 995, 1024 n.123 (1992).

308. STANLEY, *supra* note 22, at 111; Woodhouse, *supra* note 307, at 1024 n.123.

309. BUENKER, *supra* note 45, at 24. Private relief efforts were, of course, significant. During the winter of 1893-94, relief referrals increased by 50% over the previous year. "In Chicago three times as much cash relief was distributed." STANLEY, *supra* note 22, at 111.

310. Some of the more infamous incidents of labor unrest occurring after the Civil War included the July 1877 national railroad strikes, the May 1886 strike and Haymarket riot in Chicago, and the 1892 Homestead, Pennsylvania iron and steel strike at the Carnegie Steel Works. RATNER ET AL., *supra* note 70, at 317; Gilbert C. Fite, *Election of 1896, in* THE COMING TO POWER 225, 227 (Arthur Schlesinger ed., 1971).

311. RATNER ET AL., *supra* note 70, at 317; Fite, *supra* note 310, at 227; Woodhouse, *supra* note 307, at 1024 n.120.

312. Fite, *supra* note 310, at 227; Woodhouse, *supra* note 307, at 1024.

313. Democratic Senator Patrick Walsh of Georgia later declared that the Wilson Tariff Bill was "the partial fulfilment [sic] of the contest inaugurated by President Cleveland in his tariff-reform message to Congress in 1887." 26 CONG. REC. 5381 (1894).

William Jennings Bryan, a Populist leader from Nebraska, approached Chairman William L. Wilson (D-W.V.) with the possibility of attaching an income tax provision to the tariff bill. The income tax had become popular with farmers in Nebraska and elsewhere who were heavily burdened by a real property tax which effectively exempted wealthy professionals and investors.[314] A study which found that the federal system of indirect taxes claimed 70% to 90% of the poor's income, while taking only 3% to 10% of the wealthy's income, also influenced Bryan.[315] To correct these inequities Bryan sought to include an income tax with the proposed tariff reductions.[316]

Wilson, who was initially receptive to Bryan's idea, appointed Tennessee Democrat Benton McMillin to chair the Internal Revenue Subcommittee responsible for overseeing the income tax.[317] However, after receiving Bryan's proposal, which imposed a graduated tax on all incomes in excess of $2,500, Wilson and the Cleveland administration argued for separating the income tax measures from tariff reform so as not to jeopardize the latter.[318] The December 1893 report of Treasury Secretary John G. Carlisle, outlining the Administration's position, called for free raw materials, reduced rates on necessities, and only a small tax on "legacies and successions."[319] On December 4, 1893, Cleveland reiterated this position in his first State of the Union

---

314. SELIGMAN, *supra* note 30, at 495. Lawrence Friedman came to a similar conclusion:

> It was hard enough to assess land and houses fairly; at least real estate was visible, and there were records of title. Chattels were easy to hide, and intangibles most furtive of all. The general property tax essentially reduced itself to a tax on land and buildings. A rich taxpayer could easily evade taxes on invisible assets.

FRIEDMAN, *supra* note 108, at 567. Seligman argued that this failure of the general property tax to balance out the regressive effects of national consumption taxes, spurred the income tax movement:

> In theory the system of state and local taxation is calculated to reach the respective abilities of the property-owners; but in practice, as has repeatedly been pointed out, the general property tax has broken down completely; and, especially so far as personal property is concerned, the wealthier classes stand from under. Everywhere we meet the growing complaint that great wealth does not bear its share of the public burden. If, then, the tariff, as it actually exists, imposes too large a share of the burden on the expenditure of the poorer classes, and if the state and local revenue systems do not succeed in reaching the abilities of the more well-to-do classes, the argument becomes exceedingly strong in favor of some form of tax which will redress the inequality.
>
> It is this argument which, as we have seen, was really at the bottom of the movement for the income tax in 1894 . . . .

SELIGMAN, *supra* note 30, at 640.

315. LOUIS W. KOENIG, BRYAN: A POLITICAL BIOGRAPHY OF WILLIAM JENNINGS BRYAN 130 (1971). This study is most likely the one performed by Thomas G. Shearman entitled, "The Owners of Wealth," in FORUM, Nov. 1889, at 262-73. *See* BUENKER, *supra* note 45, at 32.

316. STANLEY, *supra* note 22, at 113.

317. KOENIG, *supra* note 315, at 130; STANLEY, *supra* note 22, at 113; *see also* RATNER, *supra* note 108, at 172. Ratner suggests that Bryan may have been inspired to move for an income tax by a May 8, 1893 letter from a friend, C.H. Jones, editor of the *St. Louis Republic*, advocating a graduated income tax as "the most effective weapon for use against the Plutocratic policy." *Id.* The letter goes on, however, to suggest the need to increase revenues to pay Civil War pensions through some other method than tariffs or internal revenue measures. *Id.* at 173; STANLEY, *supra* note 22, at 113 n.29. This implies a rationale closer to compensatory than redistributive.

318. RATNER, *supra* note 108, at 173; STANLEY, *supra* note 22, at 113.

319. STANLEY, *supra* note 22, at 112.

message, adding only "a small tax upon incomes derived from certain corporate investments."[320]

Without mentioning an income tax, Wilson introduced the tariff bill to the House on January 8, 1894. Nonetheless, Bryan and McMillin, who convened a Democratic caucus to appeal the decision of the Ways and Means Committee, managed to secure approval to introduce an income tax amendment.[321] Wilson, in turn, set out to make the tax more palatable, and negotiated with Bryan and McMillin for removal of the tax's graduated feature.[322] On January 29, 1894, McMillin introduced an income tax amendment to Wilson's tariff bill which proposed a 2% tax on all incomes in excess of $4,000.[323]

The resulting debate over income tax had a different tenor than during the Civil War. Although the tax was still based on the compensatory theory, the debate was directed more toward the lack of contribution from the wealthy and less toward the undue burden on the poor. For example, Representative McMillin noted that, while Congress had abandoned the income tax after the Civil War, tariff taxation "has gone steadily on, increasing from day to day and from year to year."[324] The nearly $8 per day raised from every man, woman, and child in the United States to support the government comes "almost exclusively from consumption."[325] Thus, according to McMillin, "[w]ant, not wealth, pays the taxes."[326]

Democrats blamed the pro-tariff forces' "bait and switch" tactics during Reconstruction for this inequity. Representative John J. McDannold (D-Ill.), in proclaiming his support for an income tax, cried,

> [w]e removed the tax upon the strictly revenue articles of coffee and tea under the shallow cry of a 'free breakfast table,' while we increased the tax upon the table itself, the cloth which covered it, the plates, the cups, the spoons, the knives and forks, the napkins, and everything that went to make up that 'untaxed breakfast table.'[327]

As McMillin explained, "There is $500,000 in the hands of one man that is not taxed any more than the $20,000 in the hands of the other. Is this right? Is this justice?"[328] The general sentiment of the pro-income tax forces was that the system of tariff taxation had allowed the wealthy to escape their fair share of taxation.[329] To the prolonged applause of the House, McMillin announced:

---

320. Grover Cleveland, *in* 2 UNION MESSAGES, *supra* note 303, at 1761.

321. KOENIG, *supra* note 315, at 130-31; PAUL, *supra* note 84, at 34; RATNER, *supra* note 108, at 172-73; STANLEY, *supra* note 22, at 114-15; *see* SELIGMAN, *supra* note 30, at 496-97.

322. KOENIG, *supra* note 315, at 132.

323. 26 CONG. REC. 1594 (1894); *id.* app. at 411-13 (Jan. 29, 1894) (statement of Rep. Benton McMillin) (D-Tenn.).

324. *Id.* app. at 413.

325. *Id.*

326. *Id.*

327. *Id.* at 1617.

328. *Id.* app. at 415.

329. *See id.* app. at 413 (Rep. McMillin); *id.* at 1609 (Rep. Osee Hall) (D-Minn.); *id.* at 1616 (Rep. John J. McDannold) (D-Ill.); *id.* at 1617-18, 1620 (Rep. John Sharp Williams) (D-Miss.); *id.* at 1656 (Rep. William Jennings Bryan) (Populist-Neb.); *id.* at 1664 (Rep. John Davis) (Populist-Kan.); *id.* at 1731 (Rep. Hernando de Soto Money) (D-Miss.); *id.* at 1733 (Rep. Constantine B. Kilgore) (D-Tex.); *id.* at 1755 (Rep. Edward Lane) (D-Ill.).

"I would be the most reluctant to use the power of government to tax wealth unjustly. But I am also unwilling to let wealth escape all governmental taxation."[330]

The inequity of the tariff system seemed self-evident to a society inundated with evidence as to the accumulation of wealth. "'[T]he publication of lists of millionaires was becoming a new journalistic sport.' Significantly, both the liberal Democratic *New York World*, published by Joseph Pulitzer, and the conservative Republican New York *Tribune* published lists of millionaires in the 1890s, complete with the sources of their incomes."[331] Many members of Congress were keenly aware of this concentration of wealth. Populist Senator William Allen of Nebraska read into the Congressional Record a list of New York millionaires and their annual untaxed income.[332] William Jennings Bryan quoted an essay by a member of the Census Department which concluded that 9% of the families owned 71% of the wealth.[333] South Carolina Representative William Talbert quoted Senator Daniel Voorhees' 1890 estimate that capitalists owned over 80% of the wealth.[334] The recounting of one tale told by Voorhees made clear the implications of this concentration of wealth: "When darkness settled over Egypt and she lost her place among the great nations of the earth, 3 per cent of her population owned 97 per cent of her wealth. When Babylon went down, 2 per cent of her population owned all the wealth."[335]

Income tax supporters portrayed the exclusive reliance on a consumption tax as a cause of this concentration of wealth. In this respect, McMillin stated: "The taxes having continually increased upon consumption, and no corresponding increase having been placed upon accumulation, we see such colossal fortunes amassed as were never concentrated in any other age or in any other country of the world."[336] Representative Uriel S. Hall of Missouri, believed by some to be the father of the income tax,[337] demonstrated the tariff tax's twofold benefit to the rich in a real-world context:

> [T]here was in 1889 $63,000,000, or about $1 per capita, taken from the consumers of wool and woolen goods, cotton and cotton goods, and iron and steel goods for the purpose of revenue for the United

---

330. *Id.* app. at 413.

331. BUENKER, *supra* note 45, at 28.

332. 26 CONG. REC. 6712 (1894). The incomes ranged from $1.75 million for Louis C. Tiffany to $7.6 million for John D. Rockefeller. *Id.*

333. *Id.* at 1657. George Holmes, a member of the Census Department, published an article entitled, "The Concentration of Wealth," in the December 1893 edition of the *Political Science Quarterly* which demonstrated the vast accumulations of wealth in the few and suggested that progressive income taxation be used to keep the concentration to a minimum. RATNER, *supra* note 108, at 189-90. The methods and results of such studies are open to criticism. *See* Michael Novak, *The Inequality Myth: What Wealth Gap?*, WALL ST. J., July 11, 1995, at A16. Holmes's conclusion that 9% of the population owned 71% of the wealth can be favorably compared with the strongest recent estimate that 1% of the population owns 40% of the wealth in America today. *Id.* (citing Keith Bradsher, *Gap in Wealth in U.S. Called Widest in West*, N.Y. TIMES, Apr. 13, 1995).

334. 26 CONG. REC. 1674 (1894).

335. *Id.*

336. *Id.* app. at 415.

337. PAUL, *supra* note 84, at 37; Kornhauser, *supra* note 297, at 139 n.85 (citing ROY G. BLAKEY & GLADYS C. BLAKEY, THE FEDERAL INCOME TAX 15 n.22 (1940)).

> States Government by the tariff tax. I believe that it will be safe to say that in order to secure this revenue of $63,000,000 that it cost the people of the United States $450,000,000, the balance, $387,000,000, being paid as a bounty by the people to the monopoly manufacturing establishments under this protective tariff system. In other words, for every dollar placed in the Treasury of the United States there was $7 put in the pockets of the protected manufacturers on account of the tariff tax . . . .[338]

What riled supporters of the income tax the most, however, was that the wealthy were unwilling to temper their greed and pay a proportionate share of the tax burden. Democrat John Sharp Williams of Mississippi, a consistent supporter of the income tax from 1894 through 1913, exclaimed that,

> [t]hese tax-fattened paupers, the owners of the industries which can not stand alone, the industries which the charity of the nation (by their own claim at any rate, true or false) maintains and sustains, these men grown rich by taxing all consumers for their private benefit, have the unparalleled audacity to object to being themselves taxed for the public benefit.[339]

Opponents responded that the income tax was a tax upon thrift, not upon unfair accumulation.[340] Moreover, they claimed that the wealthy as a group were not opposed to the measure. W. Bourne Cockran, a Tammany Democrat and unofficial spokesman for the wealthy,[341] reported that,

> no word of opposition to this measure . . . has ever been expressed by any rich man in the United States. On the contrary, I know that some of the wealthiest men in this country support it. I know that Mr. Gould in an interview favored it, and I am told by the gentleman from Missouri that Mr. Carnegie favors it.[342]

---

338. 26 CONG. REC. 1612 (1894).

339. *Id.* at 1620.

340. *See id.* app. at 467 (Rep. W. Bourne Cockran) (D-N.Y.); *id.* at 1599-1600 (Rep. George Washington Ray) (R-N.Y.); *id.* at 1650 (Rep. Joseph H. Walker) (R-Mass.); *id.* app. at 207 (Rep. Robert Adams, Jr.) (R-Pa.). Cockran responded to the adherents of the benefit theory that "[t]his is not a tax upon the men who have enjoyed any special benefit from the Government; it is a tax upon the men who have made the best use of the benefits which are common to all." *Id.* app. at 465.

341. The Tammany political machine in New York responded to the wishes of wealthy New York merchants and importers who favored low tariffs, but opposed taxes on the profits from those tariffs. RATNER, *supra* note 108, at 178. At the same time, the movement professed concern for the plight of the poor. STANLEY, *supra* note 22, at 118.

342. 26 CONG. REC. app. 465 (1894). Cockran was responding to a flap created when Ward McAllister, the self-proclaimed leader of a group of wealthy individuals known as the "Four Hundred," wrote a letter to the *New York World* on January 7, 1894, in which he and the group threatened to leave the country if a 2% income tax was imposed. Bryan issued the famous retort, "I have never known [a man] so mean that I would be willing to say of him that his patriotism was less than two per cent deep. [Laughter and applause]." *Id.* at 1658.

It is quite ironic that, according to one investment analyst, a Japanese entrepreneur recently remarked that he would be tempted to relocate to the United States if current efforts to adopt a flat tax are successful. *See* Sam Nakagama, *Flat Tax Would Attract Foreign Investment and Spur the Dollar*, ECONOMIC PERSPECTIVES, July 21, 1995, at 2. The crucial difference in attitude is probably attributable to the fact that present efforts suggest the possibility that investment income will be completely exempt from taxation. By contrast, tax reform in 1894 was designed to bring in-

The actions of the rich, however, belied Cockran's statements. According to Hall, the doors to the Ways and Means Committee had been "almost battered down by representatives of the manufacturing interests of the country . . . [b]ecause they know that their wealth comes from taxation."[343]

Rather than seeking a redistribution of wealth, supporters sought an income tax that was designed, like a "handmaid of tariff reform," to compensate for the tariff's regressive effects.[344] The first step was to recognize that the proposed bill utilized a variety of methods of taxation to reach a variety of classes of people. Thus, Bryan pointed out the fatal mistake made by Representative Cockran in his speech:

> You who listened to his speech would have thought that the income tax was the only Federal tax proposed; you would have supposed that it was the object of this bill to collect the entire revenue from an income tax. The gentleman forgets that the pending tariff bill will collect upon imports more than one hundred and twenty millions of dollars—nearly ten times as much as we propose to collect from the individual income tax. Everybody knows that a tax upon consumption is an unequal tax, and that the poor man by means of it pays far out of proportion to the income which he enjoys.[345]

Supporters of the income tax intended that it only "supplement"[346] the tariff tax so as to "put some little of the burden on the wealth of this country."[347] According to McMillin, "that system which gathers the taxes from divers[e] sources and which places some of its burdens upon every form of wealth, not taxing any unjustly, will be considered in the end the fairest and most just that can be devised by our people."[348] Likewise, Uriel Hall noted that, if Congress rejected the income tax, it would be declaring its willingness to lay the burdens of the tariff upon the poor, but not "to lay a feather's weight upon the great wealth of this country, . . . an argument in favor of demagogery and socialism, without righteousness for its warp and woof, and it will come back and curse us in the future."[349]

---

vestment income within the realm of taxation when it previously had gone untaxed. *See* 26 CONG. REC. 3397 (1894) (statement of Indiana Senator Daniel Voorhees, who introduced the bill in the Senate, on the theory that a propensity exists for income arising from the wealthy man's bonds and other investments to escape taxation altogether).

343. 26 CONG. REC. 1611 (1894).

344. *Id.* app. at 183 (Rep. Andrew J. Hunter) (D-Ill.) (quoting the Honorable Scott Wike).

345. *Id.* at 1656.

346. *Id.* app. at 415.

347. *Id.* at 1610.

348. *Id.* app. at 415.

349. *Id.* at 1609. Stanley suggests that this and other statements by Hall indicate that income tax supporters were motivated by a desire to acquiesce to the masses and thus avoid radical change. STANLEY, *supra* note 22, at 117. In the context of the debates, however, Hall's statement was a response to the opponents' charges that suggested the income tax was a friend of socialism. In the next sentence after the above-quoted passage, Hall said, "We are called demagogues and socialists, because we advocate this measure." 26 CONG. REC. 1609 (1894). This is not to discount the conservative tendency of most members of Congress. To suggest, though, that this rhetorical turn undercuts the honesty of Hall's support for the income tax is to ignore the tricks of debating and to give short shrift to the genuine pursuit of equality based upon a proportionate system of

In Congress, opponents of the income tax protested that the tax's exemption of the majority of the population instituted another inequality.[350] Under a compensatory theory, however, these apparent inequalities did not disrupt the overall proportionality. Hall explained, "The rule of proportionality is applicable only to the whole tax system and it may be necessary to have several partial inequalities in order to establish that final equality."[351] Since the poor "contribute more than their share to the maintenance of the state" through consumption taxes, an exemption was necessary.[352] In light of the substantial consumption tax imposed by the tariff, taxing incomes $4,000 or less, therefore, amounted to a form of "double taxation."[353] One Representative even suggested that a graduated income tax was necessary because the exemption alone would not compensate the poor for their burden under the regressive tariff tax.[354] Democrats argued that, as long as we assume that "the duties on articles of common consumption are productive," it is desirable to exempt altogether smaller incomes from the tax.[355]

Although some suggested that the exemption was itself a form of graduation,[356] more explicit graduation was rejected. With prices at their lowest levels since before the Civil War,[357] it was difficult to argue under the compensatory theory that the tariff taxes required a graduated tax. As Sherman predicted in 1870, the economic crisis of the 1890s focused people's attention on the inherent inequality of the regressive consumption tax system. There was not the same fervor for a graduated tax, however, as there had been under the rampant inflation during the war. The general impression was that an income tax with a healthy exemption was all that was required to counterbalance the regression in the system. This is not to say, though, that a graduated income tax was not advocated at all. For example, Representatives Lafe Pence from Colorado and Joseph C. Sibley from Pennsylvania both introduced amend-

---

taxation.

350. Cockran, in a rhetorical twist born out of his Tammany leanings, argued, "I oppose this bill because I will not consent by any act of mine to place the humblest or the poorest of my fellow-citizens on a political plane one shade lower than that occupied by the richest and the proudest." 26 CONG. REC. app. 465 (1894); *see also* STANLEY, *supra* note 22, at 118.

351. 26 CONG. REC. 1612 (1894) (citation omitted).

352. *Id.*

353. *Id.* at 1791.

354. Representative Lane reached this conclusion through the following logic:

> All exemptions of incomes under $4,000 are assumed to be consumable incomes and will be used in the support of families. This being so, and the Wilson bill providing for a tariff tax of $130,000,000, which is a tax on consumption, the $4,000 exempted will be liable for its just proportion of the tariff duties under the Wilson bill, which still averages 30 per cent. So even under the income tax, wealth does not yet bear its fair proportion of taxation. We should have a graduated income tax that would yield yearly nearly $100,000,000 and not $30,000,000, as is provided in the bill which we are about to pass.

Id. at 1755.

355. *Id.* at 1612 (citation omitted).

356. *Id.* at 1611. Responding to charges that he was not in favor of the principal of a graduated tax, Hall stated, "I believe that this tax is a graduated income tax. If a man has $5,000 a year he pays a tax on $1,000, or $20; if he has an income of $10,000 he pays on $6,000, or $120; and the gentleman will see that that is a graduated tax." *Id.*

357. According to the Federal Reserve Bank of New York, the cost-of-living index was at 61 in 1860, 103 in 1866, and back down to 73 in 1894. HISTORICAL STATISTICS, *supra* note 157, at 212 (Series E 183-186).

ments to graduate the income tax.[358] Others also spoke in support of a graduated tax in various forms. Income tax supporters balked, however, when they saw that the proposals were intended to redistribute rather than compensate. Hall asked of Sibley "whether he believes it is a safe principle of national legislation for us to declare that we will use the taxing power not for purposes of revenue, but for the purpose of preventing men from accumulating wealth?"[359] In the end, all amendments proposing a graduated income tax were defeated handily and the motion to adopt the income tax as an amendment to the tariff bill passed 175 to 56.[360]

When the tariff bill itself was put up to a vote, advocates of the income tax based their support on the compensatory theory. Wilson defended the income tax against charges of class legislation "by declaring that the income tax was simply an honest first effort to balance the weight of taxation so that it would not be carried exclusively by the poor consumers of the country who had hitherto borne it all."[361] Thus, support for both the tariff bill, with its attempt to reduce the burdens on the poor, and for the income tax, with its attempt to impose some burdens on the rich, was consistent with the desire to nudge the country further towards a proportionate system of taxation. Not surprisingly, Stanley found in his analysis of the roll call votes that support for these two measures "went hand in hand."[362] The income tax proponents had simply switched allies from the pro-tariff forces in the 1870s to the tariff reform forces of the 1890s. Hence, both the consumption tax, and the tariff, or internal tax, were now susceptible to attack.[363] In both cases, however, the House perceived the income tax as a critical part of the overall makeup of the federal revenue system.

When debate in the Senate commenced in March 1894, opponents of the income tax quickly sought to rebut the notion that the income tax was needed to counterbalance the effects of the tariff. Nevertheless, the force of the compensatory theory's logic prevailed. On April 2, 1894, Senator Daniel Voorhees

---

358. Pence proposed a tax which went up to 5% on incomes exceeding $100,000. 26 CONG. REC. 1730 (1894). Sibley proposed a substitute for Pence's amendment which raised the exemption to $10,000 and imposed a upper rate of 10% on incomes above $200,000. *Id.* For expressions of support, see *id.* at 1656, 1664, 1731, 1733, 1755; *id.* app. at 183 (Rep. Andrew J. Hunter) (D-Ill.).

359. *Id.* at 1730.

360. Pence's motion was defeated 112 to 66. *Id.* at 1739; RATNER, *supra* note 108, at 179-80.

361. RATNER, *supra* note 108, at 180.

362. STANLEY, *supra* note 22, at 129.

363. *See* Scott A. Taylor, *Corporate Integration in the Federal Income Tax: Lessons from the Past and a Proposal for the Future*, 10 VA. TAX REV. 237, 268 (1990). Given the fact that the pro-free-trade Democrats secured simultaneous control of the Presidency and Congress in 1892 for the first time since the Civil War, it was not surprising that income tax paired with tariff reform this time around. *See* V.O. KEY, JR., POLITICS, PARTIES, & PRESSURE GROUPS 170 (5th ed. 1964). Seligman reported that members of Congress initially looked to the prospect of increasing internal taxes to compensate for the reduction in revenues from tariff reform. SELIGMAN, *supra* note 30, at 505-06. That, however, would have left Democrats without the considerable benefit of an alliance with income tax supporters. This did not mean, however, that the Democratic supporters of the income tax did so only for revenue purposes. Quite the contrary, "correcting inequalities in the tax system" was their true goal. *Id.* at 506.

of Indiana began his introduction of the bill in the Senate in much the same manner as the bill had left the House. He explained:

> On all the wants and necessaries of life the man of wealth, with a heavy income, pays less rates of tariff tax under existing laws than the laboring man or laboring woman. . . . His bonds, his accumulated riches of all kinds, and all incomes arising from them, are exempt from all Government burdens, remaining not only undiminished and unmolested amidst darkened homes and flagrant distress, but growing fatter, stronger, and more defiant as the days and the years go by.[364]

Voorhees asked, "What is there in our system of government, or in the democratic principles on which it is founded, that exempts the rich from contributing to its support according to their means?"[365] As in the House, opponents of the income tax argued the inequality of the tax's exemption. New York Senator David B. Hill, the governor of New York from 1885 to 1891 and the chief power in the New York Democratic machine,[366] argued, "If incomes are properly taxable, then all incomes should be taxed, of whatever amount, taxed proportionally, without favoritism to any individual or class."[367] Hill argued further that a consumption tax is "the least injurious point of taxation" since consumption taxes are "self-assessed."[368] Finally, in an attempt to turn the compensatory theory against the income tax, Hill applied it to reach a different conclusion than that reached by income tax supporters. Hill reasoned that at the state and local level it was the poor, not the rich, who were escaping their due share of taxation.

> [T]he poor man who owns no real estate or personal property pays nothing directly toward State, county, or municipal taxation . . . if it were not for custom-house taxation, [the poor] would pay not a farthing toward the support of the Government which protects him and under which he enjoys the blessings and privileges of a free and independent citizen. It is through this much-abused system of tariff taxation . . . that we are enabled to equalize somewhat the burdens of government.[369]

In a similar fashion, Senator Sherman, still active twenty-five years after his service during the Civil War, attempted to justify his rejection of the income tax.[370] Sherman focused on the state's ability to levy an income tax, rather than its use of a property tax. Thus, he did "not deny that on general principles of equality and justice the incomes of the rich should contribute their full

---

364. 26 CONG. REC. 3397 (1894).
365. *Id.* at 3398.
366. RATNER, *supra* note 108, at 185.
367. 26 CONG. REC. 3559 (1894).
368. *Id.* at 3565.
369. *Id.*
370. Many members of Congress in both the House and Senate eagerly quoted Sherman's famous defenses of the income tax after the Civil War to support their arguments and to take jabs at one of the Senate's fiercest supporters of the tariff. *See id.* at 1612, 1618, 1791, 5381; *id.* app. at 183. What likely accounts for Sherman's change of heart is that the tariff fell in disfavor during the interim.

share of taxes."[371] Absent a national crisis requiring an increase in revenue, however, Sherman suggested that the states, rather than the federal government, should institute an income tax to equalize these burdens.[372]

The fallacy in these arguments was easily exposed. As Seligman later explained, "In theory the system of state and local taxation is calculated to reach the respective abilities of the property-owners; but in practice, as has repeatedly been pointed out, the general property tax has broken down completely; and, especially so far as personal property is concerned . . . ."[373] Moreover, state income taxes, championed by Sherman as the best solution, were far from realistic. With a few exceptions, most Civil War income taxes in the states were "allowed to lapse after the close of the war," not to be revived until after 1895.[374] Moreover, "because of the historically poor record of income tax administration by a number of states,"[375] few advocated state income taxes. Given these realities, and the notion that the real evil was the tariff,[376] the Senate was unwilling to dispense with the compensatory theory as support for the income tax. Georgia Democrat Patrick Walsh added to these doubts, noting that the poor already contributed their fair share to state and local governments through indirect taxes.[377] Thus, at the conclusion of the Senate debates, the Senate accepted the income tax provision, although the tariff plan was practically amended to death.[378]

Like the House, the Senate refused to adopt the proposals to graduate the tax. Populist Senators William A. Peffer of Kansas and James H. Kyle of South Dakota each proposed a graduated income tax. Peffer suggested an income tax ranging from 1% on incomes over $2,000 to 5% on incomes over $100,000.[379] Neither Peffer nor Kyle's suggestion received much consideration, however. Peffer's motion was tabled by the overwhelming vote of 45 to 5, with only Populists opposing the motion to table.[380] Stanley suggests that

---

371. *Id.* at 6694.

372. *Id.*

373. SELIGMAN, *supra* note 30, at 640.

374. *Id.* at 414.

375. CLARA PENNIMAN, STATE INCOME TAXATION 6 (1980).

376. Sherman stated, "The pretext for this measure is that some faults are found in the McKinley act." 26 CONG. REC. 6694 (1894).

377. *Id.* at 5382. This was a reference to the common suggestion that all taxes, save the income tax, were easily shifted to someone else, usually the poor, through their eventual inclusion in the price. Thus, a farmer or merchant's prices reflected his property taxes. *See* EDWIN R.A. SELIGMAN, ON THE SHIFTING AND INCIDENCE OF TAXATION (1899); Herbert Hovenkamp, *The First Great Law & Economics Movement*, 42 STAN. L. REV. 993, 1006-07 (1990) (collecting citations). In the House, Representative McDannold noted, "This is the lesson that the people have learned of the incidence of taxation. They want a tax that will stay put. [Laughter.]" 26 CONG. REC. 1616 (1894).

378. Wilson-Gorman Tariff Act, ch. 349, § 32, 28 Stat. 509, 556-57 (1894). In a display of special interest politics which would astonish even modern politicians, the Senate made no less than 634 amendments to the tariff portion of the bill, raising rates on many items. To show his displeasure, President Cleveland permitted it to become law without signing it. KOENIG, *supra* note 315, at 132-33; RATNER, *supra* note 108, at 189. By foregoing the veto, Cleveland prevented the McKinley Tariff Act from remaining in place. STANLEY, *supra* note 22, at 136.

379. *See* 26 CONG. REC. app. 666 (1894) (Rep. William A. Peffer) (Populist-Kan.); *id.* at 6689 (Rep. James H. Kyle) (Indep.-S.D.).

380. STANLEY, *supra* note 22, at 131.

the rejection of a graduated tax indicates that Democrats thought the income tax a rhetorical ploy.[381] Taking a more neutral tone, Blum and Kalven conclude that graduation was rejected in 1894 because it had not won "widespread public acceptance" after the Civil War experiment.[382] Neither of these analyses, however, is accurate. Instead, the rejection of a graduated income tax is best understood by considering the economic conditions at the time. This perceived change in economic conditions from 1864 to 1894 led most Democrats to believe that a flat income tax compensated for the burdens of the tariff during this sustained period of deflation. Hence, the income tax was principally designed to reach a class of the population which was virtually escaping taxation altogether. It elevated the overall tax rates of those who, under the consumption tax system, had paid a much lower percentage of their incomes to the government than the poor. Seligman, in discussing the 1894 Act, reminded his readers of this fact with regard to the income tax's relatively large exemption:

> It must indeed not be forgotten that we should look at the income tax as a branch of the whole revenue system. Much may accordingly be said in mitigation of this seeming injustice. As we pointed out above, the burden of taxation—that is, of the tariff and the local property tax—is borne primarily by the lower middle class, more especially by the farmers. Even though $4,000 be not a minimum of subsistence, it nevertheless represents in large part the income of a class which is on the whole unfairly treated at present.[383]

It is revealing that Stanley provides no evidence that income tax supporters, other than the Populists, signalled a commitment to explicit wealth redistribution, as opposed to burden redistribution, in their advocacy of the income tax.[384]

---

381. *Id.*

382. BLUM & KALVEN, *supra* note 33, at 12.

383. SELIGMAN, *supra* note 30, at 524. While Seligman concluded that the exemption was indeed too high, he pointed out that the exemption in England was even higher. *Id.*

384. *See* Joseph Bankman, *The Politics of the Income Tax*, 92 MICH. L. REV. 1684, 1689 (1994) (reviewing Stanley's *Dimensions of Law*) ("Stanley presents no evidence, however, to suggest that the public perceived the income tax to be anything other than it was . . . . It seems unlikely that the masses saw redistribution of wealth as an intended purpose or probable effect of the tax."). Thus, Stanley's frequent complaint that the 1894 Act, and the acts which preceded and followed it, contributed only minimally to revenues, is a bit off the mark. *See* STANLEY, *supra* note 22, at 134. The tax was not a revenue measure per se. In fact, coupled with the original reductions in the tariff, the measure could not have been expected to increase overall revenues much at all. However, when viewed as an attempt to require those 85,000 people with incomes over $4,000 to begin paying a more proportionate share of the burden, it elevates in significance. *See* 26 CONG. REC. 3398 (1894) (Sen. Daniel Voorhees) (D-Ind.) (citing an estimate of the Commissioner of Internal Revenue on the number of individuals with incomes above $4,000 out of the 65,000,000 then in the U.S.). In fact, according to Stanley's estimate, under the 1894 Act, .13% of the population was supposed to account for 3.97% of the government's overall revenues. *See* STANLEY, *supra* note 22, at 133 (Table 3-7) (Stanley cites an even lower percentage of the population, only .1%, rather than the .13% one arrives at using Senator Voorhees's numbers). If we assume that everyone contributes an equal amount under a consumption tax (which errs in Stanley's favor since many argued that the poor's goods were taxed more heavily and that the poor had larger families), then those 85,000 had their tax burdens increased substantially. As Bankman notes, "[D]ue to high exemption levels, the taxes were quite progressive and were large

Moreover, it is hard to imagine, especially when given the relative popularity of the compensatory theory, that the flat income tax was just a rhetorical ploy. Indeed, employing the income tax as a counterweight for the regressive effects of the tariff appeared to coincide with proponents' understanding of the income tax's role in the federal revenue system. According to Stanley, the *Atlanta Constitution*, for example, argued in June 1893 that the income tax "is in direct contrast with most of our tariff taxes which fall heavier on the poor than the rich, the taxes on necessaries being proportionately much heavier than those on luxuries;" the paper aptly noted that the income tax "is like a border to a carpet, . . . it completes the equipment."[385] Similarly, Representative Kyle read an article on the floor of Congress from the *Chicago Times* of April 18, 1894, which reported that "[i]t is characteristic that the attack upon the income tax was coupled with an attack upon free trade."[386] The *New York World*, and a host of other papers, agreed with this analysis. The *World* argued that "the humbler classes have at last discovered the secret of the extortion, and they demand a readjustment of burdens, adapting the share of each more nearly to the benefits received and the ability to pay."[387]

After having been prominent during the country's last debates, the compensatory theory was also undergoing a revival of sorts in academia.[388] In fact, Columbia's Edwin R.A. Seligman, said to be "the most imposing intellectual edifice in favor of graduated taxation,"[389] wrote many of his most prominent works during this period.[390] In June 1893, as the country edged closer to an income tax, Seligman wrote an article in the *Political Science Quarterly* on "The Theory of Progressive Taxation" in which he argued that a graduated income tax would "help round out the existing tax system in the direction of greater justice."[391] As he later said, the progressive income tax acts as "an engine of reparation" in the overall system.[392] Seligman was not alone in his recognition of the value of this theory. An 1891 essay contest sponsored by the journal *Public Opinion* revealed the compensatory theory's currency in the

---

enough, relative to other taxes, to alter the distribution of the aggregate tax burden." Bankman, *supra*, at 1689-90.

385. STANLEY, *supra* note 22, at 120 (citation omitted).

386. 26 CONG. REC. 6689 (1894) (Rep. Kyle) (citation omitted). Thus, according to Kyle, the *Times* predicted that the income tax in the United States "will be even more popular than in England, because under our system of raising the bulk of our revenues by tariff duties the inequalities of taxation are more glaring." *Id.*

387. STANLEY, *supra* note 22, at 120 (citation omitted).

388. *Id.* at 121.

389. *Id.* at 126. Herbert Hovenkamp has called Seligman, "the most prominent public finance economist of his day," and "[t]he Progressive Era economist with the greatest explicit influence on judicial policymaking." Hovenkamp, *supra* note 377, at 1004.

390. Joseph Dorfman, *Edwin Robert Anderson Seligman*, *in* DICTIONARY OF AMERICAN BIOGRAPHY 606, 607 (Robert L. Schuyler & Edward T. James eds., 1958).

391. Edwin R.A. Seligman, *The Theory of Progressive Taxation*, 8 POL. SCI. Q. 220, 222 (1893), *quoted in* STANLEY, *supra* note 22, at 127. It is often said, quite correctly, that Seligman subscribed to a justification of progression for its own sake based upon what he called the "faculty" theory, a variant of the sacrifice theory, which found that, on balance, people valued luxuries more than comforts, and comforts more than necessities. Taxation should thus be graduated to take into account this logic. *See* SELIGMAN, *supra* note 30, at 638; Hovenkamp, *supra* note 377, at 1005.

392. SELIGMAN, *supra* note 64, at 708.

field. The top two essays each utilized the compensatory theory in fashioning a plan for tax reform. The first prize winner, a 19-year old Wharton student, argued that "the nearest approach to equality will result from a coordination of the systems of federal, state, and local taxation, in order by this compensatory method to minimize injustice."[393] On the question of the progression principle, he noted that "the American people would not easily be reconciled to any other than a proportional income tax with an exemption of the smaller incomes."[394] The second prize winner, a 29-year old author and journalist, argued for a graduated income tax "as an offset to the disadvantages of the poor from all taxation measured by consumption."[395]

Despite its sound basis in economic theory, the 1894 income tax law was defeated by constitutional law principles. Although the tax was scheduled to take effect on January 1, 1895 and continue until January 1, 1900,[396] it was never implemented. Almost immediately after its scheduled start, two shareholder suits were filed in federal court in New York to prevent their respective corporations from paying the tax.[397] The case, *Pollock v. Farmers' Loan and Trust Co.*, was argued by some of the most prominent corporate lawyers of the day, including William D. Guthrie, Clarence A. Seward, and Joseph H. Choate.[398] *Pollack* involved a replay of many of the same issues discussed during the enactment of the income tax in Congress. Guthrie claimed that the Act was unconstitutional in one of two ways: If it was a direct tax, it was not apportioned among the states, and if it was an indirect tax like a duty, impost or excise, it was not uniform because of many discriminations, including the exemption for incomes less than $4,000.[399] Assistant Attorney General Edward B. Whitney grounded his defense of the Act upon the compensatory theory:

> It is impossible to construe this law and discuss its constitutionality or application without understanding its underlying principle. This principle is one of compensation. Certain principles of taxation are well settled, and almost universally recognized: first, that taxes on consumption bear unduly hard upon the poor and upon what is called by the economists the lower middle class, financially speaking, because the comparatively poor consume all or nearly all of their income; second, that the fairest method of equalizing taxation is by an income tax with an exemption of all incomes below a certain amount. . . . This exemption approximately represents the incomes which, prior to

393. Walter E. Weyl, *in* EQUITABLE TAXATION 28 (T.Y. Crowell & Co. 1892).

394. *Id.* at 29.

395. Robert Luce, *in* EQUITABLE TAXATION, *supra* note 393, at 44.

396. RATNER, *supra* note 108, at 191.

397. The cases were consolidated before the Supreme Court under the name Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895). As originally filed, the other case was *Hyde v. Continental Trust Co. See* WITTE, *supra* note 79, at 73 n.14.

398. BUENKER, *supra* note 45, at 16. Guthrie, called the "lion of Wall Street," raised the money for the lawsuit among his clients and found a willing litigant in Charles Pollock. FRIEDMAN, *supra* note 108, at 566.

399. *Pollock*, 157 U.S. at 448. In addition to the explicit discrimination between individuals above and below $4,000, individuals only paid on the excess over $4,000 while corporations paid a tax on the whole amount. *Id.*

> the establishment of the income tax, bore more than their fair share of taxation.[400]

Thus, Whitney continued,

> [t]he whole attack on the justice of this minimum feature is based upon a fundamental fallacy; upon the notion that the income tax stands alone instead of forming a part of a general fiscal system, the different parts of which are set to balance each other in approximation to that equality which in its perfection is "a baseless dream."[401]

Similarly, James C. Carter, attorney for the Continental Trust Company, which was the only private party defending the income tax, argued that the Act's "object was to redress in some degree the flagrant inequality by which the great mass of the people were made to furnish nearly all the revenue, and leave the very wealthy classes to furnish very little of it in comparison with their means."[402] It was clear that the compensatory theory inundated the legal understanding of equality in taxation in these arguments.

Despite the Attorney General's observation that the plaintiffs' "main reliance" was upon the Act's lack of uniform application,[403] the Court by a 6-2 vote[404] held the Act unconstitutional on the ground that it was an unapportioned direct tax.[405] On rehearing, the Court made clear that the ability of an income tax to reduce the burden on consumption was not properly the concern of the judiciary.[406] Thus, despite the vigorous dissent of four justices,[407] as

---

400. *Id.* at 475-76 (argument of Mr. Whitney).

401. *Id.* at 476 (argument of Mr. Whitney) (quoting *Head Money Cases*, 112 U.S. 580, 595 (1884)).

402. *Id.* at 517 (argument of Mr. Carter).

403. *Id.* at 504.

404. Justice Howell Jackson was absent from this first decision. BUENKER, *supra* note 45, at 19.

405. *Pollock*, 157 U.S. at 572. Article I of the Constitution provides, "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." U.S. CONST. art. I, § 9. The rule of apportionment, a compromise borne in part out of the divide between small and large states and in part out of the question of how to count slaves, requires that direct taxes such as poll or property taxes be apportioned between the states according to each state's population. SELIGMAN, *supra* note 30, at 594. In this manner, large and powerful states are prevented from imposing all the taxes on the smaller states. Indirect taxes, though, like the carriage tax in Hylton v. United States, 3 U.S. (3 Dall.) 171 (1796), were not subject to the rule of apportionment as part of the state's compromise in ceding the right to tax directly. Today, the concept of apportionment in taxation arises most frequently in the related matter of state taxation of interstate commerce. *See, e.g.*, Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. 1331, 1337 (1995).

406. Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601, 634 (1895). Justice Field, in his concurrence to the original opinion, had compared the $4,000 exemption to an "arbitrary discrimination" against Catholics and Jews. *Pollock*, 157 U.S. at 596 (Field, J., concurring). In perhaps a fit of self-interest, Field also had taken a shot at the Act's authorization of a tax upon the salaries of federal judges. *Id.* at 604.

407. The dissenting justices were Harlan, Jackson, Brown, and White. Jackson wrote that the decision had the effect of "relieving the citizens having the greater ability, while the burdens of taxation are made to fall most heavily and oppressively upon those having the least ability." *Pollock*, 158 U.S. at 705 (Jackson, J., dissenting). Harlan, in perhaps the most impassioned of the dissents, wrote:

> [U]ndue and disproportioned burdens are placed upon the many, while the few, safely entrenched behind the rule of apportionment among the states on the basis of numbers,

well as seemingly controlling authority in five prior cases,[408] the Court struck down the income tax on May 20, 1895. In a letter to his sons four days later, dissenting Justice John Marshall Harlan wrote that *Pollock* "will become as hateful with the American people as the *Dred Scott* case was when it was decided. . . . [It will] make the freeman of America the slaves of accumulated wealth."[409]

The enactment and demise of the 1894 Act reveals a solidification of the compensatory theory. The perceived need to compensate for consumption taxes, ever-present since the end of Reconstruction, was magnified when the apparent improprieties of the wealthy combined with the Panic of 1893 to highlight the lopsided distribution of the tax burden. Unlike the Civil War taxes, which were graduated to compensate for the high prices induced by the tariff and other consumption taxes, the 1894 Act was a flat tax designed to ensure that the wealthy suffered their proportionate share of the burden. While there is much discussion about the causes for the income tax's repeal in *Pollock*,[410] what is clear is that, despite the invitation of the plaintiffs' attorneys, the case did not question Congress's authority to balance the burdens of taxation through a progressive income tax.

III. THE SIXTEENTH AMENDMENT AND THE ACT OF 1913

A combination of factors led to the re-emergence of the income tax as a desirable method of taxation in the decade-and-a-half after *Pollock*. Starting around 1897, there was a gradual but significant increase in the cost-of-living to the highest levels since the Civil War, an increase for which the tariff received the primary blame. A second factor was the Panic of 1907, after which the tariff-reform Democrats, pro-income tax Progressives, and Insurgent Republicans ascended to positions of control and influence. The result was the enactment of the Sixteenth Amendment and the graduated income tax in the Underwood/Simmons Tariff Act of 1913. Much like the Civil War income taxes, the progressive rates were a response to the perception that the tariff was burdening the poor, in the form of higher prices, with more than their fair share of taxes. Thus, consistent with the country's tradition, the income tax in the Act of 1913 was used to achieve the goal of a flat or proportionate rate tax system.

> are permitted to evade their share of responsibility for the support of the government ordained for the protection of the rights of all.

Id. at 685 (Harlan, J., dissenting).

408. Justice White cited five cases for the proposition that the phrase "direct taxes" in the Constitution was intended to refer only to land: Hylton v. United States, 3 U.S. (3 Dall.) 171 (1796) (carriage tax); Pacific Insurance Co. v. Soule, 74 U.S. (7 Wall.) 433 (1868) (insurance company receipts tax); Veazie Bank v. Fenno, 75 U.S. (8 Wall.) 533 (1869) (bank notes tax); Scholey v. Rew, 90 U.S. (23 Wall.) 331 (1874) (inheritance tax); and Springer v. United States, 102 U.S. 586 (1880), which held that a Civil War income tax was not a direct tax and therefore did not need to be apportioned. *See Pollock*, 158 U.S. at 711.

409. Kornhauser, *supra* note 297, at 141 (citing David G. Farrelly, *Justice Harlan's Dissent in the* Pollock *Case*, 24 S. CAL. L. REV. 175, 180 (1950)).

410. *See, e.g.*, BUENKER, *supra* note 45, at 18-22; FRIEDMAN, *supra* note 108, at 566-67; RATNER, *supra* note 108, at 193; STANLEY, *supra* note 22, at 138.

Although deflation characterized the period before the 1894 Act, the nation saw the beginning of sharp price increases at the end of the century. It is estimated that prices increased nearly 33% between 1897 and 1913, an average of 2.3% annually.[411] The rise was more dramatic for necessities. Staples such as lard, linseed oil, flour, and butter increased in price from 45% to 184%.[412] As a result, the cost-of-living index rose from 73 in 1894 to 102 in 1912, its highest level since the Civil War.[413] More important than any actual rise in the cost-of-living, though, was the fact that Congress saw the need to respond. The Senate Select Committee on Wages and Prices of Commodities, chaired by staunch Republican Standpatter Henry Cabot Lodge of Massachusetts, wrote that "retail prices in the United States in the spring of 1910 were for many articles at the highest point recorded for many years."[414] The House Ways and Means Committee acknowledged even more dramatic concern in 1913, stating that "probably the most striking economic change since 1897 has been the tremendous increase in the cost of living—a situation which has attracted the anxious attention of economists the world over."[415]

Compounding this problem was the failure of wages to keep pace with the rise in the cost-of-living. Union wages, for example, increased by 14% from 1898 to 1907, while the cost of living rose by between 20% and 25% in the same period. One study concluded that "the purchasing power of wages increased only about sixteen percent while prices rose 36.8 percent."[416] The Senate Select Committee found that "wages have not advanced as rapidly as have prices and practically all labor difficulties which have been the subject of mediation in the United States during the past few years have had as their basis the advanced cost of living."[417]

Many blamed this inflation on the reinstitution of highly protective tariffs after the 1896 elections. Although tariff reform could not have been responsible for the Panic of 1893, Republicans seized on the Panic's lingering effects as a consequence of the declared retreat from protectionism.[418] In this man-

411. BUENKER, *supra* note 45, at 33.

412. *Id.* at 33-34.

413. HISTORICAL STATISTICS, *supra* note 157, at 212. Other indexes showed a similar rise. According to Burgess's index, the cost-of-living rose from 63.9 in 1897 to 100 in 1913; according to Douglas's index, it rose from 97 in 1894 to 137 in 1913; and according to Rees's index, it rose from 83 in 1897 to 99 in 1913. *Id.*

414. BUENKER, *supra* note 45, at 34 (quoting the Senate Select Committee on Wages and Prices, chaired by Standpat Republican Henry Cabot Lodge of Massachusetts) (citation omitted).

415. *Id.* With the House Ways and Means Committee under Democratic control by 1913, it is likely that the more dramatic rhetoric was motivated by partisan interests. *See* George E. Mowry, *Election of 1912*, *in* THE COMING TO POWER 264, 292 (Arthur M. Schlesinger, Jr. et al. eds., 1971).

416. BUENKER, *supra* note 45, at 34; HISTORICAL STATISTICS, *supra* note 157, at 212 (Series E 183-186). Although Albert Rees disproved the commonly held belief that wages remained stagnant between 1890 and 1914, it is clear that the rise in wages which did occur failed to increase workers' purchasing power appreciably. *See* RATNER ET AL., *supra* note 70, at 309 (citing ALBERT REES, REAL WAGES IN MANUFACTURING, 1890-1914 (Princeton 1961)).

417. S. REP. NO. 912, 61st Cong., 2d Sess., pt. 2, at 28 (1910), The number of strikes had indeed increased during the period, although the success rate had dropped from 50% to 36%. There were 3,100 strikes between 1911 and 1915, while there were only 530 strikes during the much longer period between 1881 and 1895. RATNER ET AL., *supra* note 70, at 317.

418. ASHLEY, *supra* note 85, at 219; KEY, *supra* note 363, at 170-71.

ner, the Republicans regained control of both houses of Congress during the midterm elections of 1894, and, with the election of William McKinley, took back the Presidency in 1896.[419] The Republicans viewed their victory as a "mandate for a high protective tariff."[420] As such, McKinley made good on his promise to erect a protective tariff in 1897 with the passage of the "strongly restrictive" Dingley Tariff Act.[421] The resulting high tariff rates came back to haunt Republicans, however, when prices began their ascent. Democrats, who capitalized on the perception that the protective tariff was to blame for high prices, called for, in their 1912 platform, "downward revision of tariff duties on grounds that existing rates made 'the rich richer and the poor poorer,' and accounted for 'the high cost of living' that plagued American families."[422] Although protectionists attempted to turn the blame against the poor and dismiss their woes as "the cost of high living,"[423] the weight of the blame fell on the tariff.[424] Moreover, despite Republican denials, leaders in both parties "agreed that the electorate's association of the rising cost of living with Republican insistence upon a high protective tariff was the single most important political issue of the day."[425]

This long-term discontent leaped to the forefront of the public's mind after the Panic of 1907.[426] This panic, which was triggered initially by the

---

419. Fite, *supra* note 310, at 225, 256.

420. RATNER ET AL., *supra* note 70, at 390.

421. BENDER'S FEDERAL REVENUE LAW, *supra* note 85, at 357; KEY, *supra* note 363, at 174. The Act instituted an average rate on dutiable goods, 52%, which was the second-highest in American history. RATNER ET AL., *supra* note 70, at 390.

422. LEROY ASHBY, WILLIAM JENNINGS BRYAN: CHAMPION OF DEMOCRACY 138 (1987); BUENKER, *supra* note 45, at 35.

423. John Buenker attributes this phrase to James J. Hill. BUENKER, *supra* note 45, at 35. Lodge's Committee similarly attempted to evade this link, contending "that 'the tariff seems to have been no national factor in causing the advance in prices during the past decade,' blaming it on the desire to 'keep up with the changing styles in clothing and shoes.'" *Id.* (quoting the Lodge Committee) (citation omitted). Obviously, it is difficult to win over allies to protectionism by insulting their spending habits.

424. Economic historians Paul Studenski and Herman Krooss note, "Rightly or wrongly, the urban population blamed the tariff for the current rise in prices." *See* BUENKER, *supra* note 45, at 37-38 (citing PAUL STUDENSKI & HERMAN E. KROOSS, FINANCIAL HISTORY OF THE UNITED STATES 270-71 (1963)).

425. *Id.* at 37.

426. Stanley dismissed the long-term discontent and focused exclusively on the action taken after the Panic of 1907. Noting the cyclical nature of the bills introduced and articles written on the income tax, he argued that the primary impetus behind the Sixteenth Amendment and the Revenue Act of 1913 was the desire to quell the depression's ensuing social instability. STANLEY, *supra* note 22, at 183. While I agree with Stanley that this refutes the traditional understanding that the Amendment was exclusively the result of a Progressive movement after *Pollock*, I think it ascribes too much force to the Panic itself. Stanley himself admits that President Theodore Roosevelt expressed his support for an income and inheritance tax in 1906, well before any sign of instability. *Id.* at 186. The American Federation of Labor Convention in 1906 also called for an income tax as a way to more equitably share the burdens of taxation, and the Democrats had called for an income tax in their party platform in every year but 1904, when they instead strengthened their antitrust provisions. BUENKER, *supra* note 45, at 42, 45. Furthermore, while the continuing high cost of living was still a source of tension in 1913, the nation's overall return to prosperity and drop in unemployment hardly resembles the conditions of the violent Pullman strikes in 1894. *See* Mowry, *supra* note 415, at 264. The Panic was important for its effect of sharply focusing attention on the inequality of the tax system which had been a nagging undercurrent since the 1890s.

failure of the Knickerbocker Trust Company and the Trust Company of America, extended through 1909.[427] During this period, relief applications increased five-fold in some cities and the manufacturing and construction industries severely cut back their labor forces.[428] Perhaps the greatest impact of the Panic, though, was its function as a vehicle for reform. The Aldrich-Vreeland Act of 1908 and the Federal Reserve Act of 1913 were proposed because of concern for the system's inability to provide adequate capital markets due to monetary inelasticity—a principal worry of the Populists during the 1890s.[429] The tariff reform area underwent similar changes, as both parties pledged support for tariff reform in the 1908 elections, and the Republicans promised to hold a special session of Congress on the subject during the next term.[430] Moreover, presidential candidates William Jennings Bryan and William Howard Taft expressed their support for an income tax, with the eventual victor, Taft, declaring in his acceptance speech that it was both constitutionally permissible and potentially desirable to have an income tax in conditions of urgent need.[431] The issues of tariff reform and the income tax were once again inextricably linked.

On March 4, 1909, Taft formally called a special session of Congress dedicated to the issue of tariff reform.[432] Later termed "one of the most contentious and significant special sessions in the history of the national Legislature," it illustrated the political breakdown which had arisen from the income tax's seeming unavailability as a method of compensation for the tariff.[433] Republicans ostensibly dominated both houses of Congress,[434] but a rift was growing in their ranks. Regular Republicans, or "Standpatters," followed the traditional party line of high protectionism. A small group of Republicans in Congress, however, were straying from this stance. Known as "Insurgent" Republicans, these primarily Western Representatives and Senators believed in

---

427. STANLEY, *supra* note 22, at 184.

428. *Id.* at 185.

429. GOODWYN, *supra* note 297, at 518-19. The Aldrich-Vreeland Act authorized groups of banks threatened by depositor panic to issue a form of emergency currency backed by certain types of their loan and investment assets. It also provided for the establishment of a National Monetary Commission to study and recommend more permanent changes, which eventually included the Federal Reserve Act. *See* RATNER ET AL., *supra* note 70, at 366.

430. Republicans offered tariff "revision" without promising reductions, while the Democrats explicitly promised tariff reductions. STANLEY, *supra* note 22, at 185-86. *See* BLAKEY & BLAKEY, *supra* note 337, at 23-24. Representative James, a Kentucky Democrat, later offered his explanation for the Republicans' promise of a special session rather than immediate action:

> The reason the Republican party would not reform the tariff before the election was they knew if they did reform it in the interests of the people, the corruption fund, which they were so used to receiving, would be denied them by the favored few with whom they were in partnership. They knew if the legislation was in the interests of monopolies, as it now is, the people would rebuke them, so they put it off until after the election.

44 CONG. REC. 4399 (1909).

431. BUENKER, *supra* note 45, at 54; STANLEY, *supra* note 22, at 186-87. For Taft, even this minimal concession was a break from most Republicans and had not been a part of the party platform. *See* Hobbs, *supra* note 179, at 453.

432. STANLEY, *supra* note 22, at 190.

433. BUENKER, *supra* note 45, at 57.

434. In the 61st Congress, Republicans held a 214-175 majority in the House and 60-32 majority in the Senate. *Id.* at 58.

a more popularly-centered focus of government, free of special perks and favors for big business. On the tariff, Insurgents sought a more "scientifically" drawn tariff policy which pinpointed protection for "legitimate" industries.[435] Although the Insurgents did not endorse a tariff for revenue only, they were allied with the Democrats in their support of an income tax on grounds of "tax equity."[436]

Given this changing political landscape, Republicans could not avoid the income tax issue when House Ways and Means Chair Sereno Payne of New York introduced a tariff bill coupled with an inheritance tax.[437] Democratic Senator Joseph W. Bailey of Texas, who was faced with tariff bills which failed to meaningfully address the cost of living issue and an inheritance tax which duplicated state programs but satisfied no one, introduced an amendment to the tariff bill proposing a flat income tax of 3% on incomes above $5,000.[438] It was, "in the main, the same as the law of 1894."[439] Bailey implied that nothing short of an income tax could serve to compensate for the tariff, and openly contested the judiciary's power to strike down the tax. In this regard, Bailey admitted that he was not attempting to conform the amendment to the Court's *Pollack*'s decision, but instead was offering an amendment that distinctly, and directly, challenged that decision.[440] Two days later the Democratic caucus adopted Bailey's proposal as a party measure.[441] In response, the Insurgents proffered an income tax bill introduced by Albert Cummins of Iowa. Cummins proposed a graduated tax ranging from 2% on incomes not exceeding $10,000 to 6% on those exceeding $100,000.[442] When twenty-one Republicans announced their support for the Cummins bill, a majority of the Senate had now registered its support for some form of an income tax.[443] Forced to confront the issue, Republican Norris Brown submitted a proposal for a Constitutional amendment granting Congress the power to collect taxes on incomes and inheritances. Brown declared he was "in full accord with the proposition of laying some of the burdens of taxation upon the incomes of the country," but was against flouting the Supreme Court's authority with the futile gesture of submitting a virtual reproduction of the 1894

435. *See id.* at 67. The call for a scientific tariff was a typical reform measure designed to remove some of the lobbyist's influence from the revenue arena. Instead of determining rates based on conjecture or political pressure, the rates would be objectively based upon data concerning the relative costs of production. Thus, cheap labor abroad would be compensated for by a tariff equal to the difference between foreign and domestic labor costs in a particular industry. *See id.* at 359; Kornhauser, *supra* note 297, at 75 n.82; Tarullo, *supra* note 73, at 292-93. One suspects that a politician's notion of a "scientifically targeted" tariff often translated into one which "protects my industries rather than yours."

436. BUENKER, *supra* note 45, at 90.

437. STANLEY, *supra* note 22, at 191-92.

438. *See* SELIGMAN, *supra* note 30, at 592 (citing 44 CONG. REC. 1351 (1909)).

439. 44 CONG. REC. 1351 (1909); *see* STANLEY, *supra* note 22, at 192-93. The inheritance tax had not even satisfied Regular Republicans, since Senate Finance Committee Chair Nelson Aldrich (R-R.I.) eliminated the tax from his version of the tariff bill submitted by the House. BUENKER, *supra* note 45, at 100.

440. 44 CONG. REC. 1351 (1909).

441. BUENKER, *supra* note 45, at 100.

442. 44 CONG. REC. 1420 (1909).

443. BUENKER, *supra* note 45, at 101.

Act.[444] Even if the Court were to reverse itself on this occasion, Brown asked, "how long will that decision stand?"[445]

The ensuing debate over these measures illustrate Congress's acceptance of the compensatory theory. On May 4, Insurgent William Borah of Idaho stood to defend Cummins' proposal. Arguing that the issue could safely be resubmitted to the Court, Borah declared that the Framers did not intend "that all taxes of this Government should be placed upon the backs of those who toil, upon consumption, while the accumulated wealth of the Nation should stand exempt."[446] Regular Republican Elihu Root, corporate counsel to such financial giants as Jay Gould, Thomas Fortune Ryan, and E.H. Harriman, took great pains to explain that the states had already adequately compensated for the tariff's regressive effects:[447]

> It is not a fact that in this Republic property does not now bear a very great proportion of the burden of taxation. . . . [T]he property in the United States upon which the ad valorem taxes for the support of the Government, county, municipal, and other local governments, were levied amounted at a true value to $97,810,000,000; that ad valorem taxes were levied upon that property at the rate of seventy-four one-hundredths of 1 per cent; that is, in round numbers, three-fourths of 1 per cent; and that would amount in round numbers to the equivalent of an income tax of 15 per cent upon all property in the United States.[448]

Of course, much like Bourne Cockran's attempt in 1894, Root's argument was open to attack. Borah asked him, "[W]ho at last pays the large portion of the real estate tax in this country, the real-estate owner or the renter?"[449] More importantly, however, income tax opponents were once again accepting most supporters' understanding of a just and equitable tax system based on flat or proportional rate taxation.

Sensing the strength of the pro-income tax position, the Democrats and Insurgents aligned to create the Bailey-Cummins bill, a compromise which proposed to ignore *Pollock* and enact a flat 2% tax on individual and corporate incomes exceeding $5,000.[450] Nelson Aldrich, the GOP's powerful leader in

---

444. 44 CONG. REC. 1568 (1909). Brown is called a "halfway Insurgent" by Sidney Ratner, although he does not define the term. He is probably "halfway" there because of his underlying support for an income tax as a supplement to the tariff, since most Regular Republicans, especially Nelson Aldrich, believed the tariff alone could provide sufficient revenue. RATNER, *supra* note 108, at 298; *see* BUENKER, *supra* note 45, at 83, 100.

445. 44 CONG. REC. 1568 (1909).

446. *Id.* at 1701.

447. BUENKER, *supra* note 45, at 60.

448. 44 CONG. REC. 1701 (1909).

449. *Id.* Borah is referencing the shifting incidence of taxation to which the income tax was allegedly not subject. *See supra* note 22. Another weakness in Root's conclusion is that he does not compare his figures with those for consumption taxes. Even if the wealthy were already subject to a 23% effective tax on their incomes, the consumption tax was historically thought by some to take 70 to 90% of the poor's income while extracting only 3 to 10% of the wealthy's income. *See* KOENIG, *supra* note 315, at 130. Thus, the property tax could not have served as a complete compensation.

450. BUENKER, *supra* note 45, at 101; STANLEY, *supra* note 22, at 195.

the Senate, succeeded in delaying the bill's introduction until the tariff issues had been resolved.[451] In the meantime, Regular Republicans, in search of a solution, approached President Taft. As Standpatter Henry Cabot Lodge explained, "they had the votes" to pass the Bailey-Cummins bill and directly challenge the Court's interpretation in *Pollock*.[452] Thus, Republican leaders adopted a compromise: a proposed amendment to the Constitution, much like Norris Brown's, but one which replaced the inheritance tax with a corporation excise tax. The compromise allowed Regular Republicans to forestall the income tax, permanently they hoped, while providing a source of revenue to replace income lost through the tariff revisions.[453] After succeeding in delaying a vote on the Bailey-Cummins bill, Aldrich managed to overcome the Democrat-Insurgent alliance's resistance and force consideration of both the amendment and corporation tax.[454]

Some suggest that the success of the compromise indicates that the income tax alliance was never on firm grounds.[455] Rather than illustrating a lack of "true" support for the income tax, though, the compromise demonstrated that the income tax's support was a function of the makeup of the entire revenue system. The tariff issue had dominated the 1908 election and Congress could not return from the special session without resolving it. Since Aldrich still had the votes and influence to control the tariff schedules, many income tax supporters acceded to the proposed solution.[456] Thus, the success of the compromise reflected the reality that this special session was focused on the burdens placed on the poor due to the tariff, rather than the lack of contribution from the rich due to the absence of the income tax. Furthermore, supporters of the compromise did not perceive that the corporation tax abandoned the goal of proportionate taxation under the compensatory theory.[457] As Borah pointed out:

> [It] has been somewhat extensively assumed, that this is another means of placing a tax upon the wealth of the country; that by this process of singling out corporations we will reach the wealth of the land rather than to place a tax upon consumers, or that great body of American citizenship which now bears its undue proportion of the taxes of the country.[458]

---

451. BUENKER, *supra* note 45, at 102; STANLEY, *supra* note 22, at 195.

452. STANLEY, *supra* note 22, at 194-95.

453. *See id.* at 199-200 (arguing that the possibility that the compromise served any other purpose than to delay the income tax, such as to raise revenues, was small given the total revenues raised from the measure).

454. BUENKER, *supra* note 45, at 105; RATNER, *supra* note 108, at 300; STANLEY, *supra* note 22, at 195.

455. *See* STANLEY, *supra* note 22, at 196. Stanley argues that if the Democrat-Insurgent alliance had enough votes to pass the income tax measure and to force the Regular Republicans to meet with Taft, it should have had enough votes to avoid the compromise altogether. *Id.* This assumes that support for the income tax was independent of the goal of tariff reform.

456. *Id.* at 195.

457. Sidney Ratner suggests that Taft's selection of a corporation excise tax after previously espousing an inheritance tax demonstrates that his support of an income tax amendment was a sham designed to hinder the Democrat-Insurgent alliance. RATNER, *supra* note 108, at 288, 291. *But see* Kornhauser, *supra* note 297, at 54 (arguing that Taft genuinely supported the corporation excise tax as a method of corporate regulation).

458. 44 CONG. REC. 3985 (1909). Borah went on to note that "the interested American people

Even if, as Borah contended, this position was a "thin guise" for truly shifting the burden back on consumers,[459] it illustrates the resonance of the compensatory theory.[460] Aldrich had always maintained that no additional revenues were needed besides the tariff, but had his view prevailed, Republicans would have had little need to justify the corporation tax as a method of equalizing the burdens of taxation.[461] As Marjorie Kornhauser has stated, rhetoric "must reflect deeply and widely held views or else it will lack the power it needs to persuade."[462] Supporters' reliance on the compensatory theory to justify the compromise demonstrates acceptance of flat or proportional rate taxation as the most just distribution of the burdens of taxation. During the debate in the House, one Republican admitted that for the wealthy, "an income tax must bear a proportionately great share of the government taxes."[463] Finally, support of a constitutional amendment was consistent with the goal of securing an income tax. In this respect, the Democratic platform in 1908 had called for the submission of a constitutional amendment to ensure the presence of "an income tax as part of our revenue system."[464] Even William Jennings Bryan had conceded in a speech in 1908 that the President should push for an income tax amendment "since it seemed improbable that Congress could design a tax which would be acceptable to the Court."[465] To a supporter of the income tax, a defeat at the hands of the Court was no better than a defeat at the hands of the state legislatures.

Debate over the wording of the amendment, although minimal, demonstrated that graduated rates were not seen as essential to achieve the goals of an income tax. On July 5, Bailey proposed that the amendment allow for ratification by popular convention and explicitly permit Congress to "grade" any income tax.[466] This latter consideration was prompted by Justice Brewer's dissent in *Knowlton v. Moore*,[467] in which the Court approved a graduated inheritance tax emerging from the Spanish-American War's revenue acts.[468] Bailey noted that if Brewer's view prevailed, and Congress was with-

---

are looking on, thinking that we are trying to get a tax upon wealth" with the corporation tax measure. *Id.* at 3986.

459. *Id.* at 3985.

460. Income tax supporters charged that the corporation tax was a "subterfuge" to defeat the income tax. *Id.* at 3929.

461. Aldrich essentially admitted that his support for the corporation tax was contrary to his views, declaring, "I shall vote for a corporation tax as a means to defeat the income tax." *Id.* He argued that it would be better to reduce expenses if the tariff did not meet needed revenues. This view, however, was not in the majority as indicated by the support for the income tax measures.

462. Kornhauser, *supra* note 297, at 138.

463. 44 CONG. REC. 4399-40 (1909) (Rep. Keifer) (R-Ohio).

464. SELIGMAN, *supra* note 30, at 591.

465. BUENKER, *supra* note 45, at 55.

466. 44 CONG. REC. 4108 (1909). The proposal for submission to popular conventions, as opposed to the state legislatures, was an attempt to assure passage was not affected by "local issues" or "change" in the representatives' opinions since the last election. *Id.* This proposal was defeated 46-30 in a vote which mirrored the vote on the substitution of the corporation tax for the income tax. BUENKER, *supra* note 45, at 131.

467. 178 U.S. 41, 110 (1900) (Brewer, J., dissenting in part and concurring in part).

468. 44 CONG. REC. 4108 (1909). The Court held that concerns about the progressive feature of the tax was a legislative rather than judicial question. *Knowlton*, 178 U.S. at 109. Brewer's

out power to grade an inheritance tax, it would also be without power, even under the amendment, to grade an income tax.[469] Senator Anselm J. McLaurin, a Democrat from Mississippi, proposed instead to remove the direct tax clauses from the Constitution altogether. He noted that this would "eliminate from the Constitution every cause of contention over the question of the authority of Congress to levy an income tax, except as to the power of Congress to grade an income tax."[470] It was clear that Bailey did not have the support in Congress to explicitly authorize a graduation of the income tax, and he withdrew the proposal, stating, "I am satisfied that this amendment will be voted down; and voting it down would warrant the Supreme Court in hereafter saying that a proposition to authorize Congress to levy a graduated income tax was rejected."[471] At a minimum, the resistance to Bailey's proposal suggests that Congress believed an income tax could exist in a meaningful sense without graduated rates. If redistribution of wealth had been the goal, there should have been at least some defense of graduation by income tax supporters. Thus, it is difficult to support the notion that the states thought they were ratifying "a predictably progressive—that is, a redistributive—income tax" when presented with the Sixteenth Amendment.[472]

---

dissent in *Knowlton* followed from his dissent in Magoun v. Illinois Trust & Sav. Bank, 170 U.S. 283, 300-01 (1898), in which the Court held that Illinois' graduated inheritance tax was constitutional. Brewer dissented on the ground that the Constitution would not permit such arbitrary discrimination. *Id.* at 303 (Brewer, J., dissenting).

An inheritance tax was often viewed differently than a tax on property or income since the former was a tax on the right of succession, a right of legislative creation, while the latter was a tax on property rights more akin to "natural" rights. *Id.* at 288. Thus, a graduated tax was not susceptible to attack under the Due Process Clause. Recognizing this, the petitioner in *Magoun* attempted to argue the case under the Equal Protection Clause. But, as one commentator noted:

> The phrase "equal protection of the laws" is so evidently intended to be indefinite that the court has never attempted to fix its meaning. They have often declared, however, that almost no classification of persons for purposes of taxation can be held to interfere with this provision of the Constitution, so long as all within a class are treated alike. Only a discrimination obviously based on grounds wholly foreign to the proper ends of government could be held unconstitutional.

Case Comment, *Illinois Inheritance Tax*, 12 HARV. L. REV. 127, 128 (1898).

In Wisconsin, for example, an inheritance tax was supported on explicitly redistributive grounds while an income tax was justified as distributing the burdens of taxation more equally. *See* Joseph A. Ranney, *Law and the Progressive Era, Part 2: The Transformation of Wisconsin's Tax System, 1897-1925*, WIS. LAW., Aug. 1994, at 22, 23 & n.16. Despite this difference in rhetoric, inheritance taxes were often flat, and were generally not steeply progressive. FRIEDMAN, *supra* note 108, at 570. Where a progressive inheritance tax was invalidated by a state supreme court, it was usually on the basis that a classification, while permissible, was arbitrary and unreasonable when made purely on a quantitative basis. *See In re* Cope's Estate, 43 A. 79, 81 (Pa. 1899); Judson A. Crane, *Progressive Income Taxes and Constitutional Uniformity of Taxation*, 2 U. PITT. L. REV. 44, 47 (1935).

An inheritance tax is also viewed differently on the moral ground that earned income may be kept while unearned income is available for redistribution. *See* Kornhauser, *supra* note 297, at 142; *see also* James K. Glassman, *The Rich Already Pay Plenty*, WASH. POST, July 11, 1995, at A17 (arguing that a flat tax is fair to the rich, but conceding that he would "be in favor of hiking estate taxes to minimize the luck of birth" in creating wealth).

469. 44 CONG. REC. 4108 (1909).

470. *Id.* at 4109.

471. *Id.* at 4120.

472. Amar, *supra* note 23, at 291. The Senate truly "agreed" on the wording of the proposed amendment, approving it 77-0 with fifteen abstentions. Certainly the goals differed, with Democrats and Insurgents voting for it "because they believed in it as the fairest form of taxation, the

From the history of ratification, it appears that the Sixteenth Amendment was more a response to the tariff than a call to redistribute wealth.[473] On August 5, 1909, Congress passed the Payne-Aldrich Tariff Act. Although it was intended to be a concession to the demand for tariff reduction, the Act maintained the high rate structure of 1897.[474] It "brought no essential change in our tariff system," with "no downward revision of any serious consequence."[475] This failure to respond to the public outcry over the tariff was fatal to the Republican Party. As Representative Adam M. Byrd, a Mississippi Democrat, warned during the debate over the compromise proposal in the House, consumers could not possibly be helped by either the Amendment or the corporation tax "unless the tax burden imposed by the tariff is decreased in proportion to the amount of revenue derived by the income and corporation taxes."[476] Thus, the tariff again assumed heightened significance during the elections of 1910 and the ensuing ratification process.[477] Consider that two-thirds of the states had not even considered the proposed amendment before 1910 and its elections.[478] These elections not only ushered in significant victories for Democrats and Insurgents, based primarily on the issue of the tariff, but also succeeded in further dividing the Republican party.[479] Democrats gained control of the governorship and both houses of Congress in New York, Ohio, Indiana, and Maine. Democrats also captured one house of the legislature and the governor's seat in both Connecticut and New Jersey, the latter electing Woodrow Wilson. Moreover, for the first time since 1890, Democrats gained control of the U.S. House of Representatives. The *New York Times*' post-election headline read, "the Democratic Party carried the Union yesterday."[480] Then, in the election of 1912, not only did Woodrow Wilson beat

---

Standpatters because it was part of the 'deal' Aldrich had agreed to and because they hoped to defeat ratification in the future." BUENKER, *supra* note 45, at 131, (quoting THOMAS R. ROSS, JONATHAN PRENTISS DOLLIVER 259-60 (1958)). The House was similarly in favor, voting 318 to 14 to approve the resolution. RATNER, *supra* note 108, at 302. Many income tax supporters no doubt felt as Representative Ollie M. James (D-Ky.) felt when he declared, "I shall vote, Mr. Speaker, to submit this constitutional amendment to the States; but when I do so, I do not concede, nor does the Democratic Party concede, that Congress has not now the power to impose such a tax." 44 CONG. REC. 4398 (1909). Representative Charles L. Bartlett (D-Ga.) expressed similar feelings, declaring his intent to vote for the resolution "because in no other way am I permitted to show my approval of this method of taxation." *Id.* at 4410.

473. For a state-by-state discussion of the ratification of the amendment, see BUENKER, *supra* note 45, at 143-58. Of course, discerning intent from the ratification of an amendment is nearly impossible in light of the many political entities involved. *See* Marjorie E. Kornhauser, *Constitutional Meaning of Income and the Income Taxation of Gifts*, 25 CONN. L. REV. 1, 11 (1992). However, the rhetoric during the process is especially revealing of the key issues.

474. BENDER'S FEDERAL REVENUE LAW, *supra* note 85, at 358; RATNER, *supra* note 70, at 390; STANLEY, *supra* note 22, at 199. Although it did little to mitigate the hostile attitude toward the tariff, the average ad valorem duty on dutiable goods went down to 42% from a high of 52% under the Dingley Tariff Act of 1897. *Id.*

475. STANLEY, *supra* note 22, at 199 (citation omitted).

476. 44 CONG. REC. 4417 (1909).

477. ASHLEY, *supra* note 85, at 252-53.

478. BUENKER, *supra* note 45, at 147.

479. *Id.* at 148-49; Mowry, *supra* note 415, at 269. In an effort to purge the party of Insurgents and Progressives, Taft had campaigned against the more radical members of his party up for re-election. Failing miserably, Taft assured himself of a sizeable group of enemies in the future. *See* KEY, *supra* note 363, at 178; Mowry, *supra* note 415, at 267.

480. BUENKER, *supra* note 45, at 148-49; Mowry, *supra* note 415, at 271.

out Taft and Roosevelt for the Presidency, but the Democrats also secured a seventy-three seat edge in the House and a six seat margin in the Senate.[481] "[M]ost analysts found the major cause of this political upheaval to be the widespread desire of voters to 'punish the Republican Party' for its belief, rational or irrational, that the high protective tariff was responsible for the escalating cost of living and for the construction of trusts."[482] Perhaps in light of this fact, almost one-half of Wilson's acceptance speech at the nominating convention "was devoted to an analysis of the protective tariff as a breeder of special privileges and special favors."[483] Similarly, in one of Taft's last messages to Congress after his defeat, he admitted that "a new Congress has been elected on a platform of a tariff for revenue only rather than a protective tariff."[484] Thus, as a reaction to the tariff, the election returned to power individuals, whether Democrat, Republican, Insurgent, or Progressive, who were willing to work toward removing some of the burden on the poor and distributing it to the wealthy. John Buenker observed that "[t]he nation's voters had rendered as clear a judgment as the vagaries of the American political process permit against the party that they associated with the high cost of living and with favoritism toward the organized and the affluent, conditions that a federal income tax was purportedly designed to counteract."[485] Ratification, achieved when Delaware voted to accept the amendment on February 3, 1913, signalled a commitment to change the Nation's overall revenue policy, not just its use of the income tax.[486] Supporters

---

481. BUENKER, *supra* note 45, at 152; Mowry, *supra* note 415, at 292. Progressives and some Insurgents, flush with their recent victories in state and federal elections, had attempted to win the Republican nomination away from Taft with Wisconsin Senator Robert La Follette as their choice for nominee. Unsuccessful, they drafted Theodore Roosevelt as their candidate and formed the Bull Moose Party. JOHN A. GABLE, THE BULL MOOSE YEARS: THEODORE ROOSEVELT AND THE PROGRESSIVE PARTY 12 (1978); WITTE, *supra* note 79, at 76. After 1912, Progressives in major offices included one governor, two senators, and 16 representatives. Mowry, *supra* note 415, at 293. Most significantly, however, was that Roosevelt outdistanced Taft for second, pulling in 88 electoral college votes to Taft's 11. GABLE, *supra*, at 131. Such impressive first-time performances led the chair of the Progressive Party, Senator Joseph Dixon of Montana, to predict that the Republicans had become a third party. BUENKER, *supra* note 45, at 153.

482. BUENKER, *supra* note 45, at 149; STANLEY, *supra* note 22, at 219. *The Nation* reported that Maine's Republican congressmen who had voted for Payne-Aldrich were "savagely heckled by the most direct and awkward questions" relating to the tariff's effect on prices. BUENKER, *supra* note 45, at 149.

483. Mowry, *supra* note 415, at 290.

484. William H. Taft (Dec. 6, 1912), *in* 3 UNION MESSAGES, *supra* note 303, at 2515.

485. BUENKER, *supra* note 45, at 154. The historic connection between the tariff and the income tax under the compensatory theory explains why the income tax itself was not a major issue, yet the election helped to spur ratification. *But see* STANLEY, *supra* note 22, at 216 (suggesting that the income tax's lack of publicity during the election proves the amendment's merely symbolic function).

486. STANLEY, *supra* note 22, at 225. Philander C. Knox, Taft's Secretary of State, formally certified the Sixteenth Amendment's adoption on February 25, 1913. RATNER, *supra* note 108, at 324; Roberts & Stratton, *supra* note 131, at 42-43. It is a bit of a red herring to imply that the time it took to ratify the amendment is a meaningful gauge of support. *See* STANLEY, *supra* note 22, at 237. The four-year delay is as much due to the infrequent meetings of the legislatures as anything else. Few legislatures were in session in 1909 after Congress passed its resolution for a constitutional amendment. The most critical year was 1911, since all but four of the states' legislatures had scheduled a session during that year. Emerging from that year lacking only eight states, ratification was again delayed since few states were in session in 1912. Moreover, New Mexico had only been recently admitted and some states, such as New York and Georgia, voted on the

claimed that "the way is now open to relieve the overladen shoulders of the poor and take the tax burdens off the necessaries of life."[487] The *New York Evening Post* predicted that "the prospect of many millions of new revenue should give the tariff-makers a much freer hand in so readjusting duties as to produce the greatest possible benefit to the consumer."[488] Perhaps heeding this advice, newly-elected President Wilson called for the twin reforms of tariff reduction and an income tax during his inaugural address in March, 1913.[489] Within a month, during an emergency session of Congress called to enact Wilson's reforms, House Ways and Means Chair Oscar Underwood (D-Ala.) introduced a tariff reform bill containing an income tax section providing for explicitly graduated rates. Drafted by Cordell Hull of Tennessee, the proposed income tax contained a "normal" rate of 1% on incomes between $4,000 and $20,000, with "surcharges" of 1% on incomes between $20,000 and $50,000, 2% on incomes between $50,000 and $100,000, and 3% on incomes greater than $100,000.[490] Hull and Underwood originally had wanted to introduce a flat tax to ensure judicial approval, but pressure from other Democrats, including future Vice-President John Nance Garner of Texas, forced the Democratic leadership to incorporate the surcharges in the rates.[491]

The ensuing debates indicate a battle between the dominant majority espousing a proportionate overall tax burden under the compensatory theory, and the small minority of Progressives and Insurgents advocating a progressive overall tax burden under the redistributive rationale. A fundamental misunderstanding of the context and underlying theories in these debates has led observers to suggest that the principle of progression had become accepted by this point. Sidney Ratner, for example, concluded that "unlike debates in previous years, [the 1913 Act] involved no dispute concerning the desirability of an income tax or even the principle of progression. The climate of public and congressional opinion had changed remarkably since 1894 and 1909."[492] Blum and Kalven, perhaps relying upon Ratner, found a similar paucity of

---

issue more than once. *See id.* at 211 (table charting the chronology of ratification); BUENKER, *supra* note 45, at 143-54; RATNER, *supra* note 108, at 306. Thus, the amendment was actually ratified after two years of meaningful consideration by the states, a swift response by most measures.

487. STANLEY, *supra* note 22, at 226.

488. *Id.* (quoting 46 LITERARY DIGEST 325-36 (1913)).

489. PAUL, *supra* note 84, at 101; WITTE, *supra* note 79, at 76.

490. BUENKER, *supra* note 45, at 368; RATNER, *supra* note 108, at 326; WITTE, *supra* note 79, at 76-77. Today, the use of a "surtax" or "surcharge" in place of an explicit rate is often disdained because it tends to hide the increase in payments. *See* Martin J. McMahon, *Renewing Progressive Taxation*, 60 TAX NOTES 109, 115 n.27 (1993). In 1913, however, the surcharge was designed to ease the administrative burden involved in collecting income taxes "at the source," or before money was paid to an individual. Although "stoppage at the source" prevented the problem of self-assessment, and thus improved collections, it created its own difficulties since a company had no way of determining a shareholder's rate bracket before making a dividend distribution. Thus, only the "normal" tax was subject to stoppage at the source, while the surcharges were collected under the traditional system of self-assessment. *See* WALTMAN, *supra* note 63, at 29.

491. BUENKER, *supra* note 45, at 361; PAUL, *supra* note 84, at 102; RATNER, *supra* note 108, at 325; WITTE, *supra* note 79, at 76. Adolph Sabath, a Chicago Democrat, had introduced a graduated income tax proposal on April 7th, 1913, which never emerged from Committee. 50 CONG. REC. 87 (1913).

492. RATNER, *supra* note 108, at 327.

conflict, stating, "Whatever the reasons, it seems that between 1894 and 1913 the deadline for sharp political debate over the progression principle had somehow passed."[493] Ironically, these analyses of the debates have it exactly backwards. Progressive income taxation in 1913 can only be understood in the context of Congress's desire to compensate for a regressive tariff which was perceived to have manifested itself in higher prices. It was not the principle of progression which had become accepted by this point, but the principle of flat or proportionate taxation.

The Democrats began the debates under a united front. With evidence of the Republican party's disintegration all around them, Democrats hoped to prevent factionalism from interfering with their first opportunity in two decades to control both Congress and the Presidency. This was not an insubstantial risk. In the Senate their margin was slim, allowing little room for cross-over votes. Democrats had a significant majority in the House, but a large number in their ranks were first-termers. Thus, the Democrats chose to iron out all decisions regarding both the tariff and the income tax in a party caucus in which each member pledged to support the party's decisions on the floor.[494] With the battle lines thus drawn, three positions emerged. Insurgents and Progressives favored significantly graduated rates, often on explicitly redistributive grounds. Regular Republicans, forced to concede that some form of income tax would be adopted, but unwilling to connect it to the tariff, attempted to push for lower exemptions and proportionate taxation so as to prevent it from becoming "class legislation." Finally, Democrats favored a moderately graduated income tax to compensate for the regressivity of consumption taxes. Once free trade could be established, however, and consumption taxes reduced to a bare minimum, the Democrats were in favor of flat or proportionate income taxation.

Soon after the bill was introduced in the House, the Progressives revealed their strategy. Ira C. Copley, a newspaper publisher from Illinois, and one of 19 Progressives in the House, proposed an amendment for steeply graduated surcharges ranging from 1% on incomes between $10,000 and $15,000 to 68% on incomes exceeding $1 million.[495] Copley left little doubt that his underly-

---

493. BLUM & KALVEN, *supra* note 33, at 12.

494. BUENKER, *supra* note 45, at 359; *see* RATNER, *supra* note 108, at 325, 328. Representative Rayburn applauded the unity of the Democrats:

> This bill was submitted to the Democratic caucus, and there every Democrat had a chance to have his say and to offer his amendment to the bill. We settled our party differences in that caucus and have come into this House and before the country with a united front, and this seems to pain our Republican brethren keenly, for they know that every amendment that they offer will be met with a solid Democratic majority and sent to the scrap heap, where it will justly repose.

50 CONG. REC. 1249 (1913) (Rep. Samuel T. Rayburn) (D-Tex.). Senator Williams observed:

> This is the first tariff bill in the history of this country where the bill was submitted to a full and free and fair discussion of every one of the dominant party in a free and fair caucus, where every man could be heard and where they merely obeyed the will of the party.

Id. at 3810 (statement of Sen. Williams).

495. 50 CONG. REC. 1246 (1913); RATNER, *supra* note 108, at 328 n.15.

ing motivation was to reduce the wealth "that is a menace to the institutions of this country":

> I have introduced this amendment for several reasons, the principal one being that I believe it to be the best way of equalizing the opportunities which society in this country offers to certain men in securing more than their fair share of the benefits derived from the labors of other men.[496]

Recognizing that his amendment would produce more revenue than the federal government could possibly use, Copley suggested that it be returned to the states "to be used by them in lightening the burdens of taxation of the poor."[497] Others followed Copley's lead, albeit with somewhat less radical proposals. Melville C. Kelly, a Pennsylvania Progressive, proposed to increase the bill's top effective rate from 4% to 9% on incomes exceeding $100,000.[498] Kansas Insurgent Victor Murdock and Washington Progressive Jacob Falconer each offered the same amendment as Kelly, but with smaller increases to 7% and 6% top effective rates respectively.[499] Although these proposals were markedly less drastic than Copley's, they were clearly cut from the same cloth. As Representative Murdock explained in introducing his proposal, "[T]he great problem remains. . . . [T]he very rich of this country succeed in doing one thing. They continue to grow richer."[500] Representative Falconer concurred, explaining that "a man can not legitimately spend $100,000 a year."[501] Each of those proposals, however, was rejected without the taking of any roll-call votes.

The approach of the Standpatters was opposite that of the Progressives. Rather than seeking to raise the top rate, the Standpatters moved to lower the bottom rate. Since they did not concede that the tariff was a tax, Regular Republicans viewed the income tax as the poor's only contribution to the government. Thus, Frederick H. Gillett, a Republican lawyer from Massachusetts, proposed to amend the bill by lowering the exemption limit to $1,000 so as to tax those with incomes between $1,000 and $4,000 at ½%.[502] According to Gillett, an income tax would permit "the great mass of the people" to "have a little feeling in their pockets as to whether the Government was economical or extravagant."[503] Representative Foster, among several Democrats "bitterly opposed" to Gillett's proposed amendment,[504] immediately contested this logic:

---

496. 50 CONG. REC. 1246 (1913).

497. *Id.*

498. *Id.* at 1251. Kelly was much less obvious than his Progressive colleague. He declared, "I would not think of attempting to outlaw all the forces which make for inequality of wealth in this nation." *Id.*

499. *Id.* at 1252 (Rep. Victor Murdock) (Kan.); *id.* at 1257 (Rep. Jacob Falconer) (Wash.).

500. *Id.* at 1252.

501. *Id.* at 1257.

502. *Id.* at 1247; RATNER, *supra* note 108, at 328.

503. 50 CONG. REC. 1247 (1913).

504. *Id.* at 1249 (Rep. Hiram R. Fowler) (D-Ill.); *see also id.* at 1247 (Rayburn); *id.* at 1250 (Rep. Alexander M. Palmer) (D-Pa.).

> The man of family, whose income is small, has usually paid a consumption tax in the way of a tariff, and has contributed his fair share of taxes to the Government, and now, if his small income is again taxed, it is more than he should be expected to bear at this time.[505]

Representative Clyde H. Tavenner (D-Ill.), responding to the charge of "the standpatters and protectionists" that the exemption is "class legislation," argued that "the present system of taxing the necessaries of life while permitting wealth to go untaxed is class legislation of the grossest sort."[506] Thus, Gillett's proposed amendment was also defeated.

For Democrats, a graduated income tax above a certain amount, and tariff reform on necessities, would together further their goal of proportionate taxation. Tavenner explained that

> the income tax is part of the Democratic plan to reduce the ever-increasing cost of living in this country. It means the carrying out of the program promised in the pre-election campaign last fall, namely, to take some of the tax off the necessaries of life, such as sugar, woolens, cottons, beef, and lumber, and to make up for the loss of revenue thus sustained by the Government by placing a tax upon incomes.[507]

Democrat Alexander M. Palmer of Pennsylvania succinctly stated that the rates had to be graduated as long as the consumption tax was still regressive: "The present consumption taxes bear most heavily upon the poor; it is right that the income tax should bear most heavily upon the rich."[508]

Eventually, however, Democrats expected that the tariff tax would be removed altogether. Representative William Murray, an Oklahoma Democrat, predicted that "we are just entering upon a policy for the support of this Government which, in a very few years, will be the only method of taxation for the support of the American Republic, and the days for protective-tariff favoritism will be over. [Applause on the Democratic side]."[509] At this time, Democrats agreed, men would be taxed "in accordance with their ability to pay instead of because of their necessity to eat and to wear clothing."[510] Because the system of property taxation was woefully inadequate to accomplish this goal, an income tax was necessary, as "the fairest and cheapest of all taxes, in order to secure to the largest extent equality of tax burdens, an adjustable system of revenue, and in all respects a modernized fiscal system."[511] Under that system, everyone would pay in proportion to his or her respective incomes.

---

505. *Id.* at 1249.
506. *Id.* at 1253.
507. *Id.*
508. *Id.* at 1250; BUENKER, *supra* note 45, at 366.
509. 50 CONG. REC. 1252 (1913); *see id.* at 1248 (Rep. Samuel Rayburn) (D-Tex.) ("[W]hen the time comes that money to defray the expenses of the Government can be raised from the income tax and other legitimate sources of direct taxation, that the tariff should be entirely removed and that free trade should come in its stead.").
510. *Id.* at 1254 (Rep. Clyde Tavenner) (D-Ill.).
511. *Id.* at 1253; BUENKER, *supra* note 45, at 369.

In the Senate, Progressives and Insurgents again attempted to increase the graduation of the rates so as to achieve truly progressive, rather than proportional, taxation.[512] William Borah of Idaho proposed to raise the top effective rate to 4% on incomes over $100,000.[513] Joseph Bristow of Kansas proposed to graduate the rates 1% for each $10,000 increase in income to a maximum effective rate of 11%.[514] Wisconsin's Robert La Follette, a Progressive Party candidate for President in 1924, also proposed a top effective rate of 11%, but suggested ½% steps from $10,000 to $40,000.[515] Finally, Miles Poindexter of Washington proposed to extend the graduation to 10% on incomes exceeding $500,000, and 20% on incomes exceeding $1 million.[516] While each of these proposals was rejected by nearly identical votes,[517] the attempt to persuade the other senators to accept a somewhat higher graduation was made with greater effect than in the House. This effect did not seem to be premised, however, on any concession toward adopting the goal of overall progression in the tax system. Although several Progressives and Insurgents did argue for explicit progression under rationales other than compensation, their arguments were fiercely opposed. Senator Poindexter argued that great wealth must be taxed at a high rate under both the benefit and sacrifice theories—that the wealth was accumulated through "special privileges" and government benefits, and that "luxuries should be taxed more heavily than necessities; that superfluity should bear a heavier portion of the burdens of the Government than mere sufficiency."[518] Senator John D. Works, a California Insurgent, boldly asserted that this great wealth had become "a positive burden to them rather than a benefit," suggesting that more steeply graduated rates would be "doing them a favor rather than an injury."[519] Senator La Follette, pointing out that most people accepted a graduated inheritance tax, asked, "instead of awaiting the opportunity to reach after death that great accumulation of wealth which the Senator has admitted is a menace, why not diminish it by a system of taxation that is constitutional, legitimate and proper?"[520] This latter argument

512. A few changes were made to the House bill by the Senate Finance Committee before introducing it on the floor for consideration by the entire chamber. The exemption was reduced to $3,000 for single persons while allowing $4,000 for married couples. The committee, after "countrywide protest," also exempted mutual life insurance companies from taxation. *See* BUENKER, *supra* note 45, at 370; RATNER, *supra* note 108, at 329.

513. 50 CONG. REC. 3771 (1913).

514. *Id.* at 3805.

515. *Id.* at 3819; *see* KEY, *supra* note 363, at 172 (Table 7.1).

516. 50 CONG. REC. 3835 (1913).

517. Borah's amendment was defeated 47-17. *Id.* at 3773. Bristow's was defeated 46-16. *Id.* at 3818. La Follette's was defeated 43-17. *Id.* at 3830. Poindexter's was defeated 41-12. *Id.* at 3836.

518. *Id.* at 3835, 4613.

519. *Id.* at 3812.

520. *Id.* at 3821. La Follette conveniently ignores that this same distinction was made in his own state of Wisconsin, which is credited as one of the models for the 1913 income tax provisions. Joseph Ranney, in surveying the debate in Wisconsin over the two measures, noted that

> [m]any supporters of property tax reform and of an income tax viewed their causes primarily as a means of distributing the obligation to support the government fairly among all classes of people. Supporters of the inheritance tax went a step further, and explicitly promoted their tax as a means of redistributing wealth from the rich to the remainder of the population.

finally provoked a heated response from Senator John Sharp Williams of Mississippi, appointed by the caucus to be one of two Democratic defenders of the income tax section in the Senate.[521]

> No honest man can make war upon great fortunes per se. The Democratic Party never has done it; and when the Democratic Party begins to do it, it will cease to be the Democratic Party and become the socialistic party of the United States; or, better expressed, the communistic party, or quasi communistic party, of the United States . . . I am not going to attempt to make this tariff bill a great panacea for all the inequalities of fortune existing in this country; nor would it do any good if we did, because we would be doctoring the symptoms and not the cause of the disease.[522]

If there was any doubt as to Williams' rejection of the redistributive rationale, he resolved them by declaring, "The object of taxation is not to leave men with equal incomes after you have taxed them."[523]

Progressives and Insurgents did make headway on their quest for steeper graduation, however, when they expressed their sentiments in terms of the compensatory theory. Senator La Follette, in introducing his proposed amendment, commented on the experience of Wisconsin and its income tax law enacted only two years earlier. He recounted the stories of individuals who had sworn that their income from personal property such as investments was no more than $5,000, when later investigation revealed incomes between $300,000 and $1 million.[524] Senator Borah remarked that this supported an argument he had voiced earlier, namely that "in order to reach proportionately the large incomes it is absolutely necessary that an almost exaggerated rate be put upon them because they do escape taxation."[525] This was a justification for graduated rates to which Williams had expressed his agreement:

Ranney, *supra* note 468, at 22. For a discussion of the possible causes for this distinction, see *supra* note 20.

521. The other was William Hughes of New Jersey, the leader of a group opposed to mandatory adherence to measures emerging from the caucus. RATNER, *supra* note 108, at 330. Williams was often thought of as a conservative Southern Democrat. *See* KOENIG, *supra* note 315, at 415 (grouping Williams with a number of southern Democrats who were against Bryan and in favor of Wilson); RATNER, *supra* note 108, at 331. However, his credentials on the income tax were impressive. According to Williams, he voted for the income tax in 1894 and introduced a joint resolution proposing an amendment to the Constitution to permit an income tax during each of his subsequent years in the House. 50 CONG. REC. 3821 (1913).

522. 50 CONG. REC. 3821 (1913). Williams issued a similar response to Senator Bristow's proposed amendment: "The motive behind the amendment offered by the Senator from Kansas is not revenue. It is a punitive, vindictive motive. It is to punish and take from those who have large incomes, not because the Government needs the money, but because the Government has the power to do it." *Id.* at 3806.

523. *Id.* at 3807.

524. *Id.* at 3820.

525. *Id.* The previous day, Borah had remarked:

> [W]e ought to bear in mind that which is proven to be well founded in experience, and that is that the man with a small income always pays more completely upon his income than the man with a large income . . . . Therefore, if we are going to reach proportionately the men with large incomes, it seems to me we must raise the grade of taxation more than is here specified.

Id. at 3771.

> So this is a graded income tax, and it does attempt to equalize things with a view to correcting what the Senator from Idaho [Mr. Borah] referred to yesterday, and which is absolutely true—the greater opportunity of men of greater income, whose incomes are generally drawn from bonds, stocks, bills receivable, and various things of that sort, to hide their incomes, as compared with the ordinary man, whose property is in a visible shape and form, and whose income is known to all his neighbors.[526]

Williams explained:

> During times of peace, you have a slight tax upon incomes, graduated not with a view of punishing those who have large incomes, but with a view of equalizing the taxes, because of the greater opportunities that people of large incomes have to escape taxation than people of small incomes have.[527]

Thus, La Follette pleaded with Democrats to "take this provision of the bill and the amendment which I have offered back to their committee room and give it consideration, to the end that these enormous incomes may be compelled at last to pay the tax they have heretofore evaded."[528]

La Follette's arguments did not fall upon deaf ears. The strength of the Democratic caucus in the Senate had been weakened from the beginning when six senators, led by William Hughes, announced they were opposed to being bound to support the measure as drafted.[529] One of these upstarts, Senator James K. Vardaman (D-Miss.), precipitated a mini-revolt by voting for La Follette's proposed amendment. Three Democrats announced the next day that they had withheld their votes on La Follette's amendment in the expectation that the Finance Committee would agree to raise its rates.[530] The Democratic caucus reconvened and reached a compromise which added three brackets so that the rates rose to 3% on incomes over $75,000, 4% on incomes over $100,000, 5% on incomes over $250,000, and a top rate of 6% on incomes over $500,000.[531] This was clearly not a victory for explicit progression, however, as the rates were much lower than those advocated by the Progressives and Insurgents, or even the radical Democrats. Furthermore, later proposals by Bristow, La Follette, and Poindexter to increase the rate of graduation on redistributive grounds were soundly defeated.[532]

---

526. *Id.* at 3807.
527. *Id.* at 3806.
528. *Id.* at 3821.
529. BUENKER, *supra* note 45, at 371; RATNER, *supra* note 108, at 330 n.24.
530. The three were Senators Eugene Reed of New Hampshire, William Thompson of Kansas, and Henry Ashurst of Arizona. BUENKER, *supra* note 45, at 374; RATNER, *supra* note 108, at 332 n.31.
531. See CONG. REC. 4611 (1913) (Sen. Joseph Little Bristow) (R-N.Y.) (explaining the Senate Finance Committee's amendments to the bill); RATNER, *supra* note 108, at 332; WITTE, *supra* note 79, at 78.
532. 50 CONG. REC. 4611 (1913) (Sen. Bristow); *id.* at 4612 (Sen. La Follette); *id.* at 4613 (Sen. Poindexter).

Meanwhile, Regular Republicans proceeded much as they had in the House. Although they believed that a protective tariff created rather than reduced income, they conceded defeat on this point.[533] On the question of the income tax, they clearly "prefer[red] that all pay proportionately and that no class be introduced."[534] Absent that, they sought a lower exemption because of the "danger to the Republic"[535] when Government is only supported by a few. Michigan Senator Charles E. Townsend pleaded, "Increase the rate if you wish on the larger incomes, but make the class of men who pay the tax as large as you can."[536] He proposed to lower the effective rate to ¼% on all incomes regardless of how small.[537] Porter McCumber of North Dakota and Elihu Root of New York both proposed to lower the exemption to $1,000, McCumber starting at the minuscule rate of one-tenth of 1%.[538] In all cases, however, these proposals were rejected. As Senator Borah explained, "So long as we have the mixed system of indirect taxation and the direct tax," we need not be concerned about those below the exemption not paying their fair share.[539]

Ultimately, the view which prevailed supported the overall goal of flat or proportionate income taxation. This understanding is best illustrated by an exchange between Regular Republican Henry Cabot Lodge, Progressive William Borah, and Democrat John Sharp Williams. Lodge argued that a high exemption was "vicious in principle" since it meant that not everyone paid his share of taxes.[540] Thus, Lodge argued, "I would not set a class apart and say they are to be pillaged, their property is to be confiscated."[541] Borah, using quotations from Seligman's *The Income Tax* to bolster his point, argued that "so long as we raise seven-eighths of our revenue by another method and only one-eighth by direct taxation, it can not be said that any man is escaping taxation."[542] Thus, Borah concluded, "When we shall adopt a system of direct taxation, exclusively and alone, I will join the Senator from Massachusetts in putting the exemptions down to a very low figure."[543] Williams then entered the fray to resolve what he termed "a purely academical discussion."[544] He explained in no uncertain terms that when the country no longer relied upon consumption taxes for its revenue, the government would embark upon flat or proportional income taxation with no exemption at all:

> There may be great merit in the argument of the Senator from Massachusetts some of these days, but not now. The reason why there is not great merit in it now is because while it taxes these people with

533. *Id.* at 3811 (Sen. Townsend) (R-Mich.).
534. *Id.* at 3801 (Sen. Lawrence Y. Sherman) (R-Ill.); *see id.* at 3810 (Sen. Townsend); *id.* at 3834 (Sen. Porter McCumber) (R-N.D.).
535. *Id.* at 3810 (Sen. Townsend).
536. *Id.* at 3811.
537. *Id.* at 4067.
538. *Id.* at 3834 (Sen. Porter McCumber) (R-N.D.); *id.* at 4067-68 (Sen. Elihu Root) (R-N.Y.).
539. *Id.* at 3835.
540. *Id.* at 3839.
541. *Id.* at 3840.
542. *Id.* at 3841.
543. *Id.*
544. *Id.*

> indirect taxes of various sorts these things should be left for some day, when the good day comes—the golden day—when there will be no taxes upon consumption at all except upon whisky and tobacco and wine and beer and things that are considered harmful, and no import duties at all except countervailing duties to offset them, and when everybody will pay in proportion to his income.[545]

Lest anyone misunderstand what he meant by that final phrase, Williams offered an example of the relative tax burdens under a proportionate income tax of 1%:

> It might then be well to reduce the exemption or to do away with it, so that a man with $5,000 would pay his $50, or whatever it was, and the man with $500 would pay his $5, and the man with $50 would pay his 5 cents, and the man who got but 5 cents would pay his 1 cent, and call it the people's pence, like Peter's pence, and let everybody pay his share.[546]

Thus, when Democrats used the term "ability to pay," they were not referring to an equality of sacrifice sometimes used to justify steeply graduated rates. Instead, they were discussing the expected transition from a system where consumption taxes accounted for all the revenues to one where taxes rose proportionately, not progressively, according to income.[547]

When the Underwood/Simmons Tariff Act went into effect on October 3, 1913, the Democrats were true to their word in pushing for gradual but significant reductions in the customs duties. Average rates were reduced from 40% to 28% with ad valorem rates lowered from 18.5% to 9.7%.[548] Similarly, the income tax compensated for the consumption taxes which remained, but did not attempt to change the distribution of wealth. As John Buenker concluded, "the original income tax was designed to promote tax equity and to produce additional revenues to allow for tariff reduction, not to redistribute wealth or income."[549] Consistent with this view, the Supreme Court, in *Brushaber v. Union Pacific R.R. Co.*,[550] upheld the tax without being asked to decide whether a redistributive tax scheme was constitutional.[551]

---

545. *Id.* As Williams had previously explained to Borah, the Democrats had not already done this because "you can not all at once remove all taxes upon consumption" where a "false and artificial fiscal system exists." *Id.* at 3808.

546. *Id.* Although the lowest figure in Williams's example amounts to a 20% rate, his reference to a "Peter's pence" indicates an intention to refer to the smallest monetary denomination feasible under that income. The phrase, derived from the notion of giving to the Church, is designed to indicate that each person should contribute what he or she is able.

547. *Id.* at 3772 (Sen. Williams) ("The time may come, and I hope will come some day, when all taxes for the Government will be raised by taxing the citizens in proportion to their ability to pay.").

548. BENDER'S FEDERAL REVENUE LAW, *supra* note 85, at 397.

549. BUENKER, *supra* note 45, at 396-97.

550. 240 U.S. 1 (1916).

551. *Brushaber*, 240 U.S. at 24-25. The Court merely decided, based on the country's prior experience with progressive income and inheritance tax rates, that it did not "transcend the conception of all taxation" so as "to be a mere arbitrary abuse of power which must be treated as wanting in due process." *Id.* at 25. At least one commentator criticized the decision. *See* Frank W. Hackett, *The Constitutionality of the Graduated Income Tax Law*, 25 YALE L.J. 427 (1916).

Although the 1913 Act instituted only mildly progressive income tax rates, it was still a significantly "progressive" reform. It was a step toward remedying an imbalance in taxation which had favored the wealthy. The period between the Civil War and the adoption of the Sixteenth Amendment was highlighted by a change in the form of wealth from real property, such as land and buildings, to intangible wealth, such as stocks and bonds. Combined with the advent of protectionism as a national policy, the poor began to view themselves as increasingly burdened by taxation while the growing fortunes of the rich largely escaped the supposedly compensatory measure of property taxation. This inequity sparked pro-income tax movements during periods of economic crisis. The resort to an income tax, however, was not designed to address the concentration of wealth itself, or even to protect the nation from instability in protest against the concentration of wealth. Instead, the income tax, with its progressive features, was adopted "to redress the inequity of taxation which was the predominant feature of the American fiscal system as a whole."[552] Thus, the history of income taxation in this country before and immediately after the ratification of the Sixteenth Amendment describes an essentially successful transformation from a regressive consumption tax-based system to a proportional or flat tax-based system.

IV. TRANSLATING 1913 INTO TODAY'S DEBATE

An understanding that the Sixteenth Amendment was ratified against the backdrop of a half-century's push toward proportionate taxation is extremely instructive for modern efforts to reform the tax system. In one sense, it undermines the notion that there is authority under the Sixteenth Amendment for an explicitly redistributive tax system, and leads to the question of why "progression today is immune from constitutional attack."[553] In a broader and more practical sense, however, the history is instructive for the lessons it provides. The current debate has directed little attention toward the overall tax burden in American society.[554] It may be that, unwittingly, we have remained faithful

---

Hackett relied to some extent, however, upon *In re* Cope's Estate, 43 A. 79 (Pa. 1899), a state inheritance tax case. It is not difficult to understand how the Court concluded that the progression was not completely arbitrary given Congress's compensatory rationale. On the other hand, it might have been a closer call if Congress had adopted Representative Copley's proposed 68% top rate based upon an explicitly redistributive rationale.

552. SELIGMAN, *supra* note 30, at 676.

553. BLUM & KALVEN, *supra* note 33, at 10. Blum and Kalven's statement is as true now as it was when written in 1952. *See, e.g.*, Thomas C. Grey, *The Malthusian Constitution*, 41 U. MIAMI L. REV. 21, 23 (1986) (reviewing Richard Epstein's *Takings* and suggesting that the Sixteenth Amendment "prevents a responsible court from demanding that Congress not increase the levels of progressivity in future years"); Joseph L. Sax, *Takings*, 53 U. CHI. L. REV. 279, 281 n.10 (1986) (reviewing RICHARD A. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN (1985)) (contending that the Sixteenth Amendment sanctioned progressivity in the tax system).

554. The attention directed toward the effects of other taxes in the system has come only recently and from relatively obscure sources. *See* Mark Adkins, Letter to the Editor, *Superrich Already Enjoy Comprehensive Federal Flat Tax*, ARIZ. REPUBLIC, Aug. 4, 1995, at B8; Norman J. Ornstein, *Congress Inside Out Taxing Thoughts on Reform: It's Not Just About Income*, ROLL CALL, Aug. 7, 1995, *available on* LEXIS, Nexis Library, CURNWS file. Few politicians have recognized this aspect of the debate.

to the original understanding of an equitable overall tax system based on flat or proportional rates. It also may be, however, that current proposals' emphasis on taxation of consumption, rather than savings and investment income, is a recipe for a repeat of the conditions leading up to the adoption of the Sixteenth Amendment. This is surely avoidable, but it has not received the focus it deserves to this point. Ultimately, no matter how consistent the theory of a flat tax is with our early history of taxation, the current debate should not be divorced from the considerations underlying that early history of taxation, including the existence of multiple points of taxation and sources of wealth.

In 1913, customs duties supplied 47% of federal tax revenues, excise taxes supplied 46%, and income taxes provided only 2%.[555] Thus, consumption taxes accounted for over 90% of total federal revenues. Currently, less than 5% of federal revenues come from excise taxes, and revenue from customs duties is minuscule.[556] While there have been some recent efforts by both Bush and Clinton to tap into these sources, their overall effect has been negligible.[557] Even when state and local taxes are included in the mix, consumption taxes still account for only 17% of all government revenues.[558] This does not mean, however, that income taxes are the only form of taxation which need concern us.

Federal revenue sources in addition to the income tax, excise tax, and customs duties include the corporate income tax, estate and gift taxes, "miscellaneous receipts," and the all-important payroll taxes for social security and medicare.[559] First established in 1935 as part of the Social Security Act, payroll taxes now account for an increasing percentage of an individual's income and have been politically insulated from attack. The social security tax rate of 3% in 1950 has increased over five-fold to the 15.3% rate we have today.[560] Since payroll taxes are assuredly not progressive, they can alter the overall character of the federal revenue system.[561] The generous exemptions proposed by many flat tax plans appear to provide a means of compensating for this regression, but, as yet, no one has attempted to explicitly justify the existence or size of the exemptions on these grounds.

Thus, if our concern is fairness, any attempt to achieve flat or proportionate taxation must take into account these other revenue sources.[562] Over the

555. RATNER ET AL., *supra* note 70, at 516, 518.

556. *Hearings, supra* note 38 (statement of Michael J. Graetz, Professor of Law, Yale University). In 1976, around 6% of federal revenues came from excise taxes and less than 1% came from customs duties. RATNER ET AL., *supra* note 70, at 516.

557. *See* John Lee, *"Death and Taxes" and Hypocrisy*, 60 TAX NOTES 1393, 1399 (1993).

558. *Hearings, supra* note 38.

559. Scott Burns, *U.S. System Taxes Our Patience*, DALLAS MORNING NEWS, July 9, 1995, at 12H.

560. Gene Steuerle, *Can Flat Taxes Be Progressive?*, 68 TAX NOTES 887 (1995).

561. RATNER ET AL., *supra* note 70, at 517; Gene Steuerle, *Postwar Changes in the Overall Tax System*, 54 TAX NOTES 1163, 1164 (1992) [hereinafter Steuerle, *Postwar Changes*]; Gene Steuerle, *The Debate over Tax Progressivity*, 47 TAX NOTES 865, 866 (1990); *see also* Burns, *supra* note 559, at 12H. Payroll taxes take 15.3% of an individual's wages. *Id.*

562. I qualify this statement because there are certainly economic reasons why income taxes may be more worrisome than other taxes due to their visibility, influence on economic decisions, and other factors.

years, several studies have concluded that our overall tax system, including all government revenues, is proportionate. Blum and Kalven cite a 1948 study which found that the overall tax system was proportionate, with only a mild element of progression at the upper end.[563] More recent studies have come to similar conclusions.[564] These studies suggest that the progression in our income taxes compensates for regression elsewhere, just as it did in 1913. Social security taxes are certainly one possible target of compensation, since they are considered "ultra-regressive" given their proportional levy up to a $61,200 ceiling of income.[565]

We should not be quick, though, to write off tax reform based on estimates of the current distribution of tax burdens. The estimates' usefulness depends upon our assumptions regarding the direction of a particular tax burden, and our understanding of the appropriate tax universe against which to measure an income tax's effects. Payroll taxes, for instance, ostensibly fund progressive redistributive programs. Perhaps these taxes should be subtracted from the mix altogether in calculating the overall tax burden.[566] Furthermore, state sales taxes, which have traditionally been thought to inject a significant degree of regressivity into the overall system,[567] have recently been to be looked at more favorably. General sales taxes often exempt consumption goods and thus have a more progressive effect, according to some studies.[568] It may also be useful to consider state and local taxes separately. State and local governments used to rely almost exclusively on property taxation and each unit of government—federal, state, or local—was seen as occupying its own sphere of taxation. It was often said that the federal government agreed to apportion its direct taxation as part of its deal with the states to acquire exclusive rights for control of customs duties, a major source of indirect taxation.[569] In such a compartmentalized tax universe, it was appropriate to consider all units of government together in determining the overall tax burden. Today, however, most states have adopted some form of income tax, and it may be valuable to consider whether each governmental unit should be evaluated separately in determining the proper distribution of tax burdens.[570] Thus,

---

563. BLUM & KALVEN, *supra* note 33, at 5 n.11 (citing R.A. Musgrave et al., *Distribution of Tax Payments by Income Groups: A Case Study for 1948*, 4 NAT'L TAX J. 1, 28 (1951)). Another study cited by Blum and Kalven, however, found that the tax system was "highly progressive" during the same year. *Id.* at 5 n.12 (citing Rufus S. Tucker, *Distribution of Tax Burdens in 1948*, 4 NAT'L TAX J. 269, 283 (1951)).

564. DAVID F. BRADFORD, UNTANGLING THE INCOME TAX 139-41 (1986) (citing a study by Joseph Pechman); *see* Allen D. Manvel, *The Pre-Reform Pattern of Tax Burdens for U.S. Families*, 35 TAX NOTES 805, 807 (1987).

565. BRADFORD, *supra* note 564, at 141; Jacob Weisberg, *Flat-Tax Fever*, N.Y. MAG., May 1, 1995, at 22.

566. Andrew J. Hoerner, *Economists Examine Whether Progressivity Has Regressed*, 56 TAX NOTES 1520 (1992); Steurele, *supra* note 560, at 888 ("Even a tax with declining rates—for instance, the U.S. social security tax that eventually imposes a zero rate on earnings above a maximum tax base—can be progressives if on net there is redistribution to lower-income individuals.").

567. *See e.g.*, Manvel, *supra* note 564, at 807.

568. Hoerner, *supra* note 566, at 1522.

569. *See, e.g.*, 26 CONG. REC. 6694 (1894) (Sen. Sherman).

570. PENNIMAN, *supra* note 375, at 8-9; RATNER ET AL., *supra* note 70, at 517; Steuerle, *Postwar Changes*, *supra* note 561, at 1164. Dan R. Bucks, executive director of the Multistate

more study is required on the overall distribution of tax burdens in our tax system. We may have a proportionate system by accident rather than design. An explicit recognition of this goal might allow us to pursue more efficient methods of achieving it.

Even if a flat or proportionate income tax should be a part of the overall mix of revenue sources, its viability still depends upon what is taxed. Most of the recent proposals, which are essentially variants on the "consumption" tax theme, exempt savings and investment income entirely.[571] Some suggest that such a tax system rewards the rich over the poor and thus "fail[s] the 'sniff test' of fairness for those who do not receive that sort of income."[572] As discussed earlier, the exemption of the rich through the nontaxation of investment income was a significant impetus to reform in both 1894 and 1913. Wealthy individuals were able to live off their investments and contribute almost nothing toward the expense of the government. It is little wonder that opponents of the current tax reform plans are conjuring up images of the Gilded Age in an attempt to demonstrate the plans' favoritism toward the rich. One commentator warns that the status quo's complexity is "a reasonable cost to retrieve the financial destiny of the nation from the voracious greed of the robber barons. Since Teddy Roosevelt, those policies have generally produced unparalleled economic vitality and a more equitable distribution of that prosperity for the American people."[573] Richard Gephardt argues that his five-rate income tax

---

Tax Commission, warned that state income tax systems are so dependent upon the national income tax that efforts to abolish or abandon the national tax would require similar action at the state level. *MTC Urges Congress to Consider Impact of Tax Reform on States*, DAILY REPORT FOR EXECUTIVES, July 31, 1995, at G146. Thus, it may be impossible to separate state and federal tax systems in considering the overall distribution of tax burdens under present and future plans.

571. Susan Dentzer, *Trial Balloons on Tax Reform*, U.S. NEWS & WORLD REP., July 31, 1995, at 43. Michael Graetz pointed out in his testimony before the Senate Committee on Finance that although flat tax proposals characterize themselves as "income" taxes, they are generally "wage" taxes which only tax the amount people consume and not the amount they save. *Hearings*, *supra* note 38.

The exemption for investment and savings income is designed to bolster the U.S.'s anemic savings rate. While "economists disagree as to whether in fact an income tax does discourage saving," and "a consumption-based tax would not necessarily eliminate all distortions in favor of consumption," politicians have latched on to tax reform as a solution to the perceived problem. JOINT COMMITTEE ON TAXATION, *supra* note 1, at 5.

572. John Godfrey, *Flat Tax Backers Stress Simplicity, but Devil Remains in the Details*, 67 TAX NOTES 167, 168 (1995) (quoting University of Michigan economist Joel Slemrod). Some of the more vocal opponents to the flat tax have highlighted this problem in writing to area newspapers. *See* S.E. Clarke, *Exploding Myths of Flat-Tax Proposals*, L.A. TIMES, July 30, 1995, at D6; Austin M. Wright, *Flat Tax Proposal Another Giveaway to the Wealthy*, CIN. ENQUIRER, Aug. 7, 1995, at A11; *see also* Tony Barga, *Flat Tax Sets Up the Middle Class*, CIN. ENQUIRER, July 26, 1995, at A9 (arguing that if double taxation of investment income is a problem, the solution is to eliminate taxation at the corporate level and make sure "we tax all income when it reaches the pocket of a human being").

Even graduated consumption tax proposals such as the Domenici-Nunn USA tax do not solve this real or perceived inequity. Joseph Isenbergh explains that, no matter how steeply graduated the rates, a graduated tax on consumed incomes would never reach the unconsumed income. Since we value wealth even before it is consumed, this creates the appearance that the wealthy are evading taxes altogether, especially, as Isenbergh graphically illustrates, "when the wealth takes the form of ancestral manors and old master paintings that produce a stream of imputed income." Joseph Isenbergh, *The End of Income Taxation*, 45 TAX L. REV. 283, 349, 354 (1990).

573. Tommy Denton, *Let's Be Fair*, BALTIMORE SUN, July 19, 1995, at 15A.

proposal "is an effort to defend working families and the middle class against the greatest, most regressive redistribution of income since the days of the Robber Barons—the Armey 17 percent flat tax."[574] Several commentators predict that the exemption of investment income from taxation will be the political undoing of the various proposals.[575] The potential rejection of this provision of current proposals, however, does not mean that the concept of a flat income tax is impossible. A "pure, unamended" flat tax applies to all income, including investment income.[576] Moreover, some observers recommend combining a value-added tax with a broad-based income tax to encourage savings and investment while maintaining the kind of vertical equity that a flat or proportionate tax system is geared to provide.[577] Coupling a consumption tax with healthy rebates for lower-income individuals could also conceivably preserve an exemption for investment income.

Moving toward a goal of flat or proportionate taxation in our revenue system should not be confused with rejecting the notion of progressivity itself. Robert Eisner proposes a tax system which would include investment income and expand credits and subsidies for earned income, health care, education, research, and owner-occupied housing, resulting in what he calls "a really progressive 'flat tax.'"[578] Others, perhaps more genuinely concerned with the reputed gains in efficiency from radical reform, advocate a flat tax with progressive credits for lower-income individuals.[579] The point is that the tax system should have little to do with the welfare system or the safety net enacted during the New Deal. Taxes should redistribute money from the private sector

---

574. Letter to the Editor, *The Rich Should Pay Plenty*, WASH. POST, July 22, 1995, at A20 (responding to James Glassman, *The Rich Already Pay Plenty*, WASH. POST, July 11, 1995, at A17).

575. *See* Robert Kuttner, *Dueling Tax Plans: One Adds Up, the Other Doesn't*, BUS. WK., May 15, 1995, at 28; *What Should Be Taxed Will Be the Key Issue*, WALL ST. J., May 1, 1995, at A1. The public's disgruntlement with the evasion of taxes by the wealthy was not limited to the turn of the century. Michael Graetz testified that he "remember[ed] well the outrage generated in 1969 by Treasury Secretary Joe Barr's revelation that 154 people that year had more than $200,000 in adjusted gross income and paid no taxes, the beating taken by Mrs. Dodge, in particular, who had $1 million of tax-exempt interest and no tax liability." Graetz also recalled "the expressions of outrage generated in 1986 when the laborers on General Electric's assembly line paid more taxes than the company." *Hearings*, *supra* note 38.

576. Editorial, *Reformers Really Want a Flat Tax with Wrinkles*, PALM BEACH POST, July 15, 1995, at 14A; Howard Gleckman, *Tax Reform Is Coming, Sure. But What Kind?*, BUS. WK., June 12, 1995, at 84.

577. Supporters of this idea include Yale Law professor Michael Graetz, former Treasury Secretary Nicholas Brady, and former Senators Danforth and Boren. *See Hearings*, *supra* note 38; Edward J. McCaffrey, *Tax Policy Under a Hybrid Income-Consumption Tax*, 70 TEX. L. REV. 1145, 1148 (1992). Isenbergh advocates a similar approach designed to achieve progressivity, but his approach is easily modified to approximate proportionate taxation and his commitment to progressive rates is merely a concession to the political popularity of the concept. Isenbergh, *supra* note 572, at 350. Ironically, this solution essentially replicates the hybrid consumption-income tax system instituted in 1913.

Vertical equity represents the notion that taxpayers with larger amounts of income should contribute larger amounts of tax. Jay M. Howard, 32 WASHBURN L.J. 43 (1992). These amounts could be proportionately or progressively larger depending upon the goals of the overall tax system.

578. Robert Eisner, *Make Taxes Fair, Not Flat*, WALL ST. J., Apr. 11, 1995, at A20.

579. *See* Bankman and Griffith, *supra* note 34, at 1966; Howard J. Gensler, *The Secret History of the U.S. Flat Tax*, 56 TAX NOTES 1657 (1992).

to the public sector, "the government can then spend the money as progressively as it wants."[580] As Charles Galvin points out, many "institutional arrangements" in our society redistribute wealth much more effectively than the tax system.[581]

CONCLUSION

John Sharp Williams declared in 1913 that advocates of a tax system geared toward progression and redistribution "are always considering something in a tax besides the tax; something in a tax besides the revenue."[582] This observation still holds true today. The current system is encrusted with the conflicting social goals of generations of policymakers. Moreover, the total tax burden has been affected in ways which may be contrary to the announced intentions of Congressional enactments. Proponents of radical tax reform should now strive to ensure, as their intellectual forefathers did from the Civil War through the ratification of the Sixteenth Amendment, that the tax system does not introduce its own inequities into the system while raising sufficient revenue to operate the government. That goal is difficult enough.

580. *Should America Keep Its "Progressive" Tax System?*, INVESTOR'S BUS. DAILY, July 24, 1995, at B1 (quoting economist Arthur Laffer).

581. Charles O. Galvin, *Would Haig-Simons Plus a Flat Tax Be the Best U.S. Tax System?*, 60 TAX NOTES 540 (1993).

582. 50 CONG. REC. 3821 (1913).

REDRAFTING U.C.C. SECTION 2-207: AN ECONOMIC PRESCRIPTION FOR THE BATTLE OF THE FORMS

DANIEL T. OSTAS*
FRANK P. DARR†

Perhaps more criticism has been leveled against section 2-207 than any other provision of the Uniform Commercial Code.[1] The section addresses contract scenarios in which commercial parties have failed to bargain effectively. In the typical case, both the offeror and offeree used standardized forms to memorialize their agreement, yet neither read the other's form. When contractual problems materialize, the parties discover that the terms on the two forms conflict. Section 2-207 attempts to answer three questions. First, does the exchange of conflicting forms constitute a binding contract? Second, if a binding contract exists, what are its enforceable terms? Third, if the exchange of forms does not establish a contract, but the parties nonetheless perform, what are the terms of the contract established by conduct? Unfortunately, judicial interpretations of section 2-207 vary widely, making the answers to these questions far from clear.[2]

---

* Assistant Professor, University of Maryland.
† Associate Professor, Ohio State University.

1. For a representative sampling of the literature, see Douglas G. Baird & Robert Weisberg, *Rules, Standards, and the Battle of the Forms: A Reassessment of Section 2-207*, 68 VA. L. REV. 1217 (1982); John E. Murray, Jr., *The Chaos of the 'Battle of the Forms': Solutions*, 39 VAND. L. REV. 1307 (1986) [hereinafter Murray *Chaos*]; Gregory M. Travalio, *Clearing the Air After the Battle: Reconciling Fairness and Efficiency in a Formal Approach to U.C.C. Section 2-207*, 33 CASE W. RES. L. REV. 327 (1983). The *Business Lawyer* devoted a recent symposium issue to the current efforts to redraft § 2-207. Contributions include: Henry D. Gabriel, *The Battle of the Forms: A Comparison of the United Nations Convention for the International Sale of Goods, the Common Law, and the Uniform Commercial Code*, 49 BUS. LAW. 1053 (1994); Daniel A. Levin & Ellen B. Rubert, *Beyond U.C.C. Section 2-207: Should Professor Murray's Proposed Revision Be Adopted?*, 11 J.L. & COM. 175 (1992); Thomas J. McCarthy, *An Introduction: The Commercial Irrelevancy of the 'Battle of the Forms'*, 49 BUS. LAW. 1019 (1994); Mark E. Roszkowski & John D. Wladis, *Revised U.C.C. Section 2-207: Analysis and Recommendations*, 49 BUS. LAW. 1065 (1994); John D. Wladis, *U.C.C. Section 2-207: The Drafting History*, 49 BUS. LAW. 1029 (1994).

For a useful appendix summarizing all known proposals for redrafting § 2-207, see Mark E. Roszkowski, *Ending the Battle of the Forms: A Proposed Revision of U.C.C. Section 2-207*, 26 UCC L.J. 144, 164-71 (1993). Articles cited in Professor Roszkowski's appendix include: John E. Murray, *A Proposed Revision of Section 2-207 of the Uniform Commercial Code*, 6 J.L. & COM. 337 (1986); Corneill A. Stephens, *On Ending the Battle of the Forms: Problems with Solutions*, 80 KY. L.J. 815 (1992) [sic]; and Charles M. Thatcher, *Sales Contract Formation and Content—An Annotated Apology for a Proposed Revision of Uniform Commercial Code Section 2-207*, 32 S.D. L. REV. 181 (1987).

2. Professors White and Summers devote 21 pages of their treatise to problems generated by § 2-207. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 28-49 (3d ed. 1988). Their review of applicable case law reveals a variety of inconsistent interpretations and

Current efforts to redraft Article 2 include reforms to section 2-207.[3] This article addresses the redrafting effort. It begins with a brief review of the problems associated with the battle of the forms. Next, it identifies and applies three central tenets associated with the economic analysis of the law: respect for individual autonomy, reduction of transaction costs, and provision of legal stability. Armed with these economic insights, the article next turns to the proposed section 2-207, and suggests ways to improve the final product. The article emphasizes the need to uphold the clear intent of the parties, but when that intent is not clear, the courts should draw upon the Article 2 gap-filling provisions, including the customary business practices that the parties are presumed to understand. The article concludes with proposed language for a new section 2-207.

I. THE BATTLE OF THE FORMS: CURRENT STATUTORY TREATMENT

A. *The Mirror Image Rule*

The common law of contracts took shape in the simpler days of the late-eighteenth and early-nineteenth centuries.[4] The formation rules in particular were based on quaint notions of agreement. For example, if two farmers dickered over the sale of a horse, the principals negotiated the terms of the contract face to face. The buyer checked the horse's teeth, inquired into its lineage, and haggled over the sales price. If the seller and buyer reached a meeting of the minds, a contract was formed. If the offer and the acceptance conflicted, however, there was no agreement. Under the rubric of the "mirror image rule,"[5] the common law demanded strict evidence of contractual agreement before imposing a binding transfer on the parties.[6]

Much of modern contract law involves a strikingly different social setting. Industrialization, mass marketing, and the creation of large and sometimes market-dominating firms led to the prevalence of standardized forms.[7] Today, the typical commercial sales agreement involves corporate agents exchanging forms, complete with unread and unexamined boilerplate.[8] The purchasing

---

problems associated with the section. *Id.*

3. A Drafting Committee was created by the Permanent Editorial Board for the Uniform Commercial Code, with the approval of the National Conference of Commissions on Uniform State Laws and the American Law Institute. The Drafting Committee began work in 1991 and has produced a series of draft revisions. The most current official draft of § 2-207 is dated December 20, 1994. *See infra* notes 62-73 and accompanying text.

4. Professor Horwitz observes that "the entire conceptual apparatus of modern contract doctrine—rules dealing with offer and acceptance, the evidentiary function of consideration, and especially canons of interpretation" were firmly in place by the early nineteenth century. MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW 1780-1860, at 160-61 (1977).

5. Under the "mirror image rule," a reply that purports to be an acceptance but that varies the offer's terms is not an acceptance, but a counteroffer. RESTATEMENT (SECOND) OF CONTRACTS §§ 58, 59 rep.'s note regarding cmt. a; WHITE & SUMMERS, *supra* note 2, at 29.

6. Professors Baird and Weisberg argue that the mirror image rule was seldom applied so rigidly as to allow parties to welsh. Baird & Weisberg, *supra* note 1, at 1233-36.

7. Professor Slawson estimates standard forms are used in up to 99% of all contracts. W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 529 (1971).

8. *See* Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28

agent fills in a few blanks on her purchase order, then signs and mails the document. The sales agent notes the quantity, price, and subject matter reflected on the order form and responds with a confirming memo, invoice, or other acknowledgment form reflecting these central terms. The problem, of course, is that the boilerplate on the purchase order may conflict with that found on the acknowledgment. The respective corporate agents nonetheless assume that the uninspected forms constitute a contract, staple the two forms together, and toss them in a filing cabinet. The forms are removed and inspected only if a conflict arises.

Under the mirror image rule, the exchange of conflicting forms does not establish a contract. Prior to performance, either party is free to back out of the deal.[9] If the parties nonetheless perform, that is, if the goods are shipped and received, then the conduct of the parties forms a contract.[10] The purported "acceptance" form is interpreted as a counteroffer which the buyer accepts by his or her actions.[11]

The mirror image rule can be criticized on two fronts. First, by refusing to recognize a contract upon the exchange of forms, the law provides a perverse incentive for parties to "welsh" on bona fide agreements.[12] Both agents initially assume that the exchange of forms creates a contract. If market conditions change, and one party decides to renege on the agreement, that party can assert the mirror image rule and refuse to follow through with the deal. Second, the mirror image rule gives an unwarranted preference to the terms contained in the acceptance/counteroffer.[13] Since taking delivery is interpreted as "accepting" the unread terms of the seller's acknowledgment, the acknowledgment controls, and the purchase order becomes irrelevant. Though the drafters of section 2-207 sought to correct these shortcomings,[14] the results have been less than stellar.

AM. SOC. REV. 55, 56-58 (1963); *see also* Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 WIS. L. REV. 1 (surveying current contract practices and practitioners' opinions on elimination of the legal sanctions for breach, the role of the law in practitioners' behavior, and the proper treatment of frustration).

9. *See, e.g.*, Poel v. Brunswick-Balke-Collender Co., 110 N.E. 619 (N.Y. 1915) (buyer took advantage of the mirror image rule when market price fell); Cram v. Long, 142 N.W. 267 (Wis. 1913) (mirror image rule provided an excuse even though differences in offer and reply were relatively minor).

10. *See* JOHN E. MURRAY, JR., MURRAY ON CONTRACTS 113 (1974).

11. *Id.*

12. Professors White and Summers note that the primary purpose of § 2-207 was to change the mirror image rule so as to hold the bad faith welsher to the deal. WHITE & SUMMERS, *supra* note 2, at 28-29.

13. This is commonly referred to as the "last shot" rule. The party who sends the last form has an advantage. *See* JAMES BROOK, SALES AND LEASES: EXAMPLES AND EXPLANATIONS 56 (1994).

14. For a thorough discussion of the drafting history of § 2-207, see Wladis, *supra* note 1; *see also* Murray *Chaos*, *supra* note 1, at 1311-22 (discussing § 2-207 in light of the overall purposes of U.C.C. Article 2).

B. *Finding a Contract on the Exchange of Forms: Section 2-207(1)*

Section 2-207(1) provides that an executory contract can indeed be formed on the exchange of conflicting forms. It states:

> A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.[15]

The subsection explicitly addresses the welsher problem. Once the parties have exchanged forms that purport to establish an agreement, a contract is formed, and neither party may renege. This is true even if the acceptance contains *additional* or *different* terms.

The subsection works in concert with sections 2-204 and 2-206. Section 2-204 provides that a contract "may be made in any manner sufficient to show agreement."[16] Section 2-206 states that an offer "shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances."[17] When section 2-207 is read with sections 2-204 and 2-206, an exchange of conflicting boilerplate suffices to show agreement (Section 2-204), and a conflicting acknowledgment can be a reasonable means of accepting an offer (Section 2-206). These three agreement provisions follow the basic themes of Article 2: emphasis on the factual bargains of the parties, good faith, and the relevance of general commercial understandings.[18]

The difficulty with section 2-207(1) lies in distinguishing a "definite expression of acceptance" from an "expressly conditional acceptance."[19] The subsection provides that an "expression of acceptance" serves as an "acceptance" even if it contains "different" or "additional" terms, *unless* the responding party makes its expression of acceptance "expressly conditional."[20] But what does it mean to make an acceptance expressly conditional? Will a sufficiently large discrepancy between offer and acceptance suffice? What if the expressly conditional language is lost in a tangle of fine print? Must the

---

15. U.C.C. § 2-207(1) (West 1994).

16. Section 2-204 provides:

> (1) A contract for the sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.
>
> (2) An agreement sufficient to constitute a contract for the sale may be found even though the moment of its making is undetermined.
>
> (3) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

U.C.C. § 2-204 (West 1994).

17. Section 2-206 provides in pertinent part:

> (1) Unless otherwise unambiguously indicated by the language or circumstances
>
> (a) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances . . . .

U.C.C. § 2-206(1)(a) (West 1994).

18. *See* Murray *Chaos*, *supra* note 1, at 1311-19.

19. *See* Baird & Weisberg, *supra* note 1, at 1224-26.

20. U.C.C. § 2-207(1).

expressly conditional language be conspicuous; and if so, how conspicuous?[21] Unfortunately, current law provides uncertain answers. Any redraft of section 2-207 must find a way to address this shortcoming.

C. *Determining the Terms of the Contract: Section 2-207(2)*

Once a court determines that an exchange of forms establishes a contract, it then must determine the terms of that contract. As quoted below, section 2-207(2) provides the statutory guidance. The subsection explains that when a term is reflected in the responding party's form, but absent in the initial form, the term enters the contract as a so called "additional term."

> The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:
>
> (a) the offer expressly limits the acceptance to the terms of the offer;
>
> (b) they materially alter it; or
>
> (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.[22]

Unfortunately, section 2-207(2) contains at least two major difficulties. First, the subsection gives a strong preference to offerors. Section 2-207(2)(b) distinguishes between "material" and "immaterial" additions. Immaterial additions, therefore, can surreptitiously enter a contract through an unexamined acceptance form while material additions cannot. For a material addition to attach, the offeror must expressly consent. By definition, parties care much more about material additions than about immaterial ones; hence, it is much safer to be an offeror than an offeree. To compound matters, terms reflected in an offer that are not contradicted in the acceptance would seem to summarily enter a contract.[23] In other words, if the offer spells out an additional material term, such as a warranty provision, it becomes a term of the contract, but the same uncontradicted warranty provision in the acceptance does not.

This preference afforded to offerors creates an incentive to be the first party to send a confirming memorandum or standardized form. In many situations, however, it is unclear which party constitutes the true offeror. For example, if a corporation has a standing offer to sell to its repeat customers, then the purchase order may be considered an acceptance. Alternatively, if the parties discussed a sale informally and reached an agreement, section 2-207 suggests that the first party to send a confirming memorandum becomes the offeror. Surely, justice demands more than a casual inquiry into which corporate agent mails its form first.

---

21. *See* discussion *infra* notes 58-61.

22. U.C.C. § 2-207(2).

23. Professors White and Summers consider whether silence in an acceptance can ever override an express provision contained in the offer, and conclude that it cannot. WHITE & SUMMERS, *supra* note 2, at 36.

A second problem with section 2-207(2) arises from its silence regarding "differing" terms. When conflicting boilerplate addresses the same issue differently, should the courts cancel both terms, should they follow the offer, or should the acceptance control? Section 2-207(1), seeking to remedy the weaknesses of the mirror image rule, made possible the creation of a contract despite "different" terms.[24] Section 2-207(2) addresses "additional" terms, but is silent regarding "different" or conflicting terms. Section 2-207(3) applies only when the writings of the parties do not constitute an agreement; hence, it provides no guidance with regard to differing terms when the forms establish a contract.[25]

Courts have not been consistent in their response to this statutory gap.[26] Professors White and Summers identify three widely divergent paths followed by various courts in assessing the effects of differing terms.[27] First, some courts seem to preserve portions of the mirror image rule. A differing form is viewed as either a "counteroffer" or as a "proposal to modify" that is accepted by the other party upon shipment or the taking of delivery.[28] Under this "last hit" rule, the advantage rests with the party who sends the last form. Second, and in stark contrast to the "last hit" rule, other courts seem to honor the first form. Here, the rationale is that since the U.C.C. does not explicitly provide a means for a differing term to modify an offer, such differing terms cannot enter the agreement.[29] Hence, under this "first hit" interpretation, the offer controls. Finally, other courts have reasoned that when terms conflict, the courts should cancel both terms and supply a judicial gap filler derived from the general provisions of Article 2.[30] Determining which rule will be followed, therefore, seems to depend more on the skill of the advocates and the identity of the judge than on the language of the U.C.C.[31]

D. *Opting Out of the Battle: Section 2-207(3)*

The final subsection addresses scenarios in which the exchange of forms or other writings are insufficient to establish a contract. Section 2-207(3) states:

---

24. *See supra* text accompanying note 15.
25. *See infra* text accompanying note 32.
26. *See* WHITE & SUMMERS, *supra* note 2, at 33-35.
27. *Id.*
28. *Id.* at 33 (citing Roto-Lith, Ltd. v. F.P. Bartlett & Co., 297 F.2d 497 (1st Cir. 1962)).
29. *Id.* at 34 (citing, among other cases, Reaction Molding Techs., Inc. v. General Elec. Co., 588 F. Supp. 1280 (E.D. Pa. 1984)).
30. *Id.* (citing Daitom, Inc. v. Pennwalt Corp., 741 F.2d 1569 (10th Cir. 1984)).
31. In our view, the best interpretation of the current law on "differing terms" begins with a careful separation of contract *formation* from contract *content* issues. If no executory contract is created on the exchange of forms, but the parties nonetheless perform, then the gap filler approach of § 2-207(3) controls. *See infra* text accompanying note 60. By contrast, if the exchange of forms establishes an executory contract under § 2-207(1), then, under current law, the terms of the offer control. The point, however, is that alternative statutory constructions are not only possible, but followed in many courts. Interestingly, Professors White and Summers disagree on the preferred approach. White prefers the gap filler solution. WHITE & SUMMERS, *supra* note 2, at 34. Summers would create a preference in favor of the offer, the "first shot" rule. *Id.* at 34-35.

> Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the contract do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings agree, together with any supplementary terms incorporated under any other provisions of this Act.[32]

This provision becomes operable when the exchange of forms cannot reasonably be construed as forming a contract pursuant to section 2-207(1), but the parties nonetheless behave (by delivery and acceptance of goods) as though they have a contract.

Sometimes, express conflicts in the writings are inadvertent. For example, the parties informally agree on a sale, and each sends a confirming memo. One memo calls for a price twice that of the other. Notwithstanding the divergence on this central term, the seller delivers and the buyer takes delivery. Section 2-207(1) arguably would not create a contract because the memos do not state a "definite and seasonable expression of acceptance." But the conduct of the parties will salvage the contract, with the courts providing a reasonable price in accord with other provisions of Article 2.[33]

More commonly, section 2-207(3) becomes operable due to the design of one or both of the parties. Lawyers who draft form contracts are fully aware of the problems and pitfalls introduced by thirty years of judicial development. As a consequence, most commercial forms contain a clause stating that the terms contained in that particular form must control the agreement and no others.[34] In addition, these clauses typically state that performance by the other party will be construed as an acceptance of all the terms contained in the expressly conditional form.

If pursuant to section 2-207(1) the court determines that such a clause renders an agreement "expressly conditional," then no contract is established on the initial exchange of writings. If the parties nonetheless perform, then a statutory interpretation issue arises.[35] Under an expansive reading of section 2-207(3), one could argue that the "writings of the contract do not otherwise establish a contract"; hence, the terms of the contract "consist of those terms on which the writings agree, together with any supplementary terms" incorporated by Article 2. Alternatively, under a narrow reading, one could argue that these facts do not raise a section 2-207(3) issue at all. There simply was an offer, or perhaps a counteroffer, that was accepted in accord with its terms—through performance. Although we prefer the more expansive reading, the point is that both interpretations carry favor with the courts, again leading to inconsistent results and unnecessary litigation.

In conclusion, each of the three subsections of section 2-207 has created some confusion. Perhaps section 2-207(1) fairs best. Although it reflects an

---

32. U.C.C. § 2-207(3).

33. U.C.C. § 2-305 provides judicial authority to impose a price term omitted by the parties.

34. *See* McCarthy, *supra* note 1, at 1022.

35. Professor Murray refers to this recurring fact pattern as the "counter-offer riddle." Murray *Chaos*, *supra* note 1, at 1322-26, 1343-54.

admirable attempt to keep the bad faith welsher in the deal, it provides little guidance on how to distinguish a "definite and seasonable expression of acceptance" from an acceptance "expressly made conditional." Section 2-207(2) appears to be a dismal failure on at least three fronts. First, it replaces the mirror image rule's preference for offerees with a preference for offerors. Second, the statutory gap with reference to "different" terms has led to inconsistent judicial results.[36] Third, section 2-207(2) provides scant guidance for the courts to distinguish immaterial terms from material terms. Finally, section 2-207(3) has failed to provide a clear answer to the expressly conditional "counter-offer riddle" addressed above. Any redraft of section 2-207 must find a way to address these shortcomings.

II. AN ECONOMIC PRESCRIPTION FOR REFORM

The economic approach to law can help guide current reforms of section 2-207.[37] At the heart of the inquiry are three basic tenets: respect for individual autonomy, reducing transaction costs, and providing legal stability.[38] These tenets provide a useful guide for solving the classic formation and terms questions presented by a battle of forms.

A. *Respect for Individual Autonomy*

The economic approach to contract law begins with the proposition that all mutually understood agreements between competent individuals should be summarily enforced. Expressed under the rubric of "freedom of contract," this governmental respect for individual autonomy has been a guiding tenet of economic theory since the days of Adam Smith.[39] It continues to guide the economic approach to contract law.

It is useful to divide the notion of freedom of contract into two parts: freedom *to* contract and freedom *from* contract.[40] Freedom *to* contract recognizes the truism that individuals do not agree to contractual exchanges unless each believes that the exchange will make him or her better off. Individuals have idiosyncratic knowledge about the details of a particular exchange unavailable to governmental authorities. Hence, any attempt by government to impose external limits on the substance of a private exchange must overcome

---

36. *See supra* notes 26-31 and accompanying text.

37. By "economic" approach we refer to that body of literature usually traced to Ronald Coase's seminal essay and expounded by Judge Posner. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (3d ed. 1986); R.H. Coase, *The Problems of Social Cost*, 3 J.L. & ECON. 1 (1960); *see also* ANTHONY T. KRONMAN & RICHARD A. POSNER, THE ECONOMICS OF CONTRACT LAW (1979); READINGS IN THE ECONOMICS OF CONTRACT LAW (Victor P. Goldberg ed., 1989).

38. *See generally* Daniel T. Ostas & Burt A. Leete, *Economic Analysis of Law as a Guide to Post Communist Legal Reforms: The Case of Hungarian Contract Law*, 32 AM. BUS. L.J. 355 (1995) (developing and applying the three tenets in a comparative law setting); Daniel T. Ostas & Frank P. Darr, *Understanding Commercial Impracticability: Tempering Efficiency with Community Fairness Norms*, 27 RUTGERS L.J. (forthcoming 1996) (applying the three tenets to the doctrine of commercial impracticability).

39. *See* JOSEPH SCHUMPETER, HISTORY OF ECONOMIC ANALYSIS 185-87 (1954).

40. *See, e.g.*, Richard E. Speidel, *The New Spirit of Contract*, 2 J.L. & COM. 193 (1982).

a strong burden.[41] Freedom *from* contract, by contrast, stands for the proposition that individuals should not be forced, absent prior consent, to transfer property rights, or other entitlements. By insisting that each trading partner obtain the informed consent of the other, each must take into account the idiosyncratic knowledge of the other. Thus, forced transfers imposed by the courts frustrate the information flow process, distort market prices, and lead to the inefficient allocation, distribution, and use of property rights.[42]

The "battle of the forms" reflects the tensions between the twin concerns of freedom *to* and freedom *from* contract. Allowing a party to welsh on a bona fide exchange erodes the principle of freedom *to* contract; yet, imposing unbargained for terms on a party violates the notion of freedom *from* contract. Section 2-207 strives to balance these competing concerns. It states that a "seasonable expression of acceptance or written confirmation" forms a binding contract. It then struggles to determine the terms of that contract.

To an economist, only subjectively understood agreements satisfy the notion of a mutually beneficial exchange.[43] Ideally, the autonomy inquiry is a subjective one—what did the parties understand to be their agreement? Lacking divine insight, however, this subjective inquiry ultimately becomes objective. The courts ask not what the parties were thinking, but rather, whether there is sufficient *objective evidence to infer a subjective agreement.*[44]

Objective evidence of subjective intent originates from two sources. First, negotiated terms agreed to by the parties and those contained on each form give objective evidence as to those terms.[45] Second, conduct of the parties,

---

41. *Id.* at 524. The burden, of course, is not insurmountable. For example, economic reasoning supports governmental intervention in cases of unconscionability and commercial impracticability. *See generally* Daniel T. Ostas, *Predicting Unconscionability Decisions: An Economic Model and an Empirical Test*, 29 AM. BUS. L.J. 535 (1991) (using economic theory to predict unconscionability outcomes); Ostas & Darr, *supra* note 38 (justifying governmental intervention for commercial impracticability on economic grounds). Governmental "intervention" is also needed to fill in the omissions in contracts. Omissions occur for a variety of reasons. For example, an omission may result from the calculated desire of a party in the weaker bargaining position to enter the bargain without a particular clause with the hope or expectation that the problem will not occur. E. Allan Farnsworth, *Disputes over Omission in Contracts*, 68 COLUM. L. REV. 860, 872-73 (1968).

42. *See generally* Friedrich A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 519-30 (1945) (defending the doctrine of freedom of contract as a means to economize on idiosyncratic and widely dispersed information).

43. KRONMAN & POSNER, *supra* note 37, at 5.

44. Many contract doctrines serve this evidentiary inquiry. For example, doctrines that require a writing, insist upon an exchange of consideration, or inquire into the presence of fraud or duress, all seek to "objectify" an inherently subjective inquiry. *See* Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 272-74 (1986); *see also* Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553 (1933) (discussing the interplay between objective and subjective inquiries into consent). The inevitable slippage in these evidentiary surrogates leads to both over-enforcement and under-enforcement of contractual language. Over-enforcement occurs when the courts impose a contract absent true individual consent. Under-enforcement results from a judicial unwillingness to impose transfers that were indeed consensual. The battle of the forms must respond to this tension. If it follows an economic logic, it will seek to minimize the sum of over-enforcement and under-enforcement costs.

45. One must recognize that contractual terms may be inextricably integrated in the minds of the parties. The seller is willing to sell at price X, but only if its boilerplate warranty disclaimer is upheld. The buyer may be willing to pay X, but only if a standard warranty of merchantability applies. Hence, the apparent agreement on price becomes illusory, and holding the parties to that

trade practice, industry custom, and past dealings all play a role in determining intent. For example, each party is presumptively aware of the customary terms associated with their transaction. Each party knows or should know that a sale of goods typically includes a warranty of merchantability. Each knows or should know whether their industry typically submits contractual disputes to arbitration. They presumably are aware of the industry custom regarding the effect of acts of God. If they have dealt with one another in the past, they are aware of how they have resolved any prior disputes. Such shared customs and experiences facilitate communication and provide evidence of mutual, albeit tacit, understandings.[46] In the context of the battle of the forms, therefore, evidence of industry custom and past dealing may provide better evidence of mutual understandings than the fine print within the unexamined boilerplate on the conflicting forms.

In short, the principle of autonomy suggests a preferred emphasis on the negotiated terms and commonly implied terms based on usage of trade, industry practices, past dealings, and customary gap fillers provided by Article 2. The parties presumptively transact within this context, and it provides a ready basis for meaningful agreements. In this light, the key question becomes: do the incongruent forms give sufficient objective evidence to warrant a judicial inference that the parties have subjectively agreed to vary from trade customs? Of course, due deference to individual autonomy demands that parties be empowered to specifically tailor their own contracts. Custom must not become a straightjacket. But autonomy also demands sufficient evidence of both parties' consent to such tailoring.

B. *Reducing Transaction Costs*

Our second economic tenet provides that contract law should do more than passively enforce private transactions; it should proactively[47] seek to make transactions less costly for the parties.[48] It is important to recognize the sound business reasons for firms to use standardized forms. Standardized forms reduce bargaining costs by relieving firms of the burden of individually negotiating and drafting contract provisions regulating relatively routine transactions.[49] Such forms also reduce agency costs by limiting the contractu-

---

express price can no longer be justified on the mere grounds that the forms do not conflict on that term. Since the principle of autonomy is no guide, the court should determine the price with an eye toward creating a precedent that encourages future parties to bargain more effectively. *See infra* text accompanying notes 47-54.

46. *See* Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 885-97 (1992).

47. Contract law reduces transaction costs in three ways: (1) by summarily enforcing express contractual agreements it provides a disincentive for breach; (2) by providing standard customary terms it removes the necessity to bargain over all the details of a particular exchange; and (3) through the laws of fraud, undue influence, duress, and unconscionability it discourages misleading conduct in contract negotiations. KRONMAN & POSNER, *supra* note 37, at 4. All three concerns are motivated by battle of the forms.

48. Transaction costs include the costs of bargaining, performing, and enforcing contractual matters. Ostas & Leete, *supra* note 38, at 366. Enforcement costs, including the costs of litigation, are discussed under our third tenet—providing legal stability.

49. Advances in technology continue to reduce these costs by replacing standard forms with

al discretion of subordinants within a firm's hierarchy, and facilitate centralized control by harmonizing contracts through that firm's national or international business activities. Any resolution of the battle of the forms problem, therefore, should respect the efficiency of standardized forms.

Current law, however, fails to take advantage of standardized forms. In some situations the seller's form will control, while in other cases the buyer's form will control. Thus, the current 2-207 creates a perverse incentive to carefully read and consider the fine print on each and every invoice or purchase order received. Someone within the corporate hierarchy should then be authorized to negotiate these terms. Such a rule increases costs and erodes the contractual harmony within an individual firm. For example, a seller may use a warranty disclaimer in all its forms. In transactions where the seller is deemed the offeror the disclaimer enters; when deemed the offeree it does not enter. Hence, the uniformity gains of form contracting erode.

The solution is to rethink the role of forms and the terms emerging from conflicting forms. Transaction-cost reasoning suggests that the preferred approach is to deemphasize the boilerplate language in favor of customary terms as derived from the past dealings of the parties, common trade practices, and standard gap-filling terms provided by the U.C.C. An emphasis on customs facilitates communication in accord with the principle of autonomy[50] and reduces bargaining costs by preserving the efficiency gains of standard forms. Gap fillers would provide a baseline understanding which boilerplate could not alter. Opportunism through surreptitiously entering an uncustomary or surprising term in unexamined boilerplate would not be rewarded. Once the parties form a contract under section 2-207(1), it would include terms agreed upon, terms reflected on both forms, and terms supplied by the Article 2 gap fillers.[51] There would be no need to scrutinize each other's forms, and the uniformity in a firm's sales activity would be enhanced. The rule would negate the incentive to be the offeror.

Transaction-cost logic also provides insights into the substance of customary terms. Many customs, or gap fillers, involve the allocation of risk. For example, an implied warranty in the sale of goods assigns the risk of faulty workmanship to the seller rather than the buyer. Liability for goods damaged during shipping is customarily assigned to the common carrier. In each case, it is in the interest of all parties that contractual risks be allocated to the party who can absorb them more efficiently.[52] Hence, reliance on custom not only

---

"electronic data interchanges." McCarthy, *supra* note 1, at 1024.

50. *See supra* text accompanying note 45-46.

51. Relational interests developed over a period of time often create enforceable legal obligations. *See generally* IAN R. MACNEIL, THE NEW SOCIAL CONTRACT (1980) (dealing with the roots of contract, its role in projecting exchange into the future, and the normative aspects of contracts). While a sales contract, standing alone, is hardly the prototypical relational contract, the courts will look to the parties' history to determine the materiality of an additional term. *See, e.g.*, St. Charles Cable TV v. Eagle Comtronics, Inc., 687 F. Supp. 820, 827 (S.D.N.Y. 1988), *aff'd*, 895 F.2d 1410 (2d Cir. 1989). Thus, context and history of the transaction serve important roles in limiting the parties' negotiating costs.

52. *See* POSNER, *supra* note 37, at 85.

facilitates communication and preserves the efficiency gains associated with form contracting, it also tends to reduce performance costs.[53]

Of course, parties must be permitted to individually craft their contract to vary from custom. Although a seller *usually* is more efficient in taking precautions that assure product quality, sometimes the buyer is more efficient.[54] In such cases, the parties should not rely on standard forms. Instead, they should negotiate fully. An "expressly conditional" form as envisioned by section 2-207(1) would signal the need for meaningful negotiations. If the uncustomary warranty disclaimer is really in the interests of both parties, then reaching an agreement on a disclaimer should not be difficult. The need for allowing an expressly conditional form is borne out by the next tenet as well.

C. *Providing Legal Stability*

Properly conceived, transaction costs include not only the costs of negotiating and performing contracts, but also the costs of enforcing or litigating contractual matters. Vagueness or uncertainty in the law frustrates attempts by the parties to settle their own disputes and increases the need for costly litigation. Any redraft of section 2-207, therefore, should strive for clarity and ease of judicial administration.

As discussed previously, judicial interpretations of section 2-207 vary widely.[55] Hence, when judged by a stability standard, the section generally fails. On first blush, the mirror image rule appears to fair better. By insisting that the parties reach a full accord on all express terms, the rule seems to limit judicial discretion. But even with the mirror image rule, if there has been part performance, the court must still order restitution or fashion some sort of quasi-contractual adjustment. Thus, the gains in legal predictability are not as great as may first appear.

By contrast, a rule which emphasizes customary gap fillers should be much easier to implement. First, the courts would ask whether the exchange of forms together with the conduct of the parties indicates an intention to be bound. "A definite expression of acceptance"[56] as envisioned by section 2-207(1), or "[c]onduct by both parties which recognizes the existence of a contract," as envisioned by section 2-207(3),[57] would suffice to bind the parties. Welshing would not be permitted. Once the contract was formed, the terms would be: (1) those upon which the parties had in-fact agreed; (2) those that consistently appeared on both forms; and (3) supplemental gap fillers derived from industry customs, past dealings, and provisions of Article 2.

---

53. As part of the reform process, all Article 2 gap fillers are under review. Sellers seem particularly keen on changing the implied warranties provided by the U.C.C. *See* Roszkowski & Wladis, *supra* note 1, at 1068-69.

54. *See* Baird & Weisberg, *supra* note 1, at 1250-51 (using this illustration as a reason to return to a modified version of the mirror image rule).

55. *See supra* text accompanying notes 26-31.

56. This standard would complement §§ 2-204 and 2-206. *See supra* notes 12-14 and accompanying text.

57. *See supra* text accompanying note 32.

Either party could avoid the creation of a contract on the above terms by *conspicuously* indicating on its form that its offer or acceptance was "expressly conditional,"[58] and then refuse to deliver the goods or to take delivery until the other party expressly agreed to the non-customary term.[59] The conspicuously conditional language would preserve the right to "welsh," and would signal the need to negotiate. The conditional terms, however, could not be agreed to by mere performance.[60] If the parties shipped and took delivery without first engaging in meaningful negotiations, then agreed terms, matching terms, and gap fillers would control. In effect, the gamesmanship associated with trying to be the last party to send a form (described as the counteroffer riddle) would be avoided by simply eliminating it.

The principle of legal stability would be served on a number of fronts. First, the conspicuousness requirement would provide a "safe harbor" for parties who wished to enter meaningful negotiations, instead of relying on standard forms, thereby clarifying section 2-207(1). Second, under our proposal there would be no need to distinguish between offeror or offeree, between material and immaterial terms, or between "different" and "additional" terms as envisioned by section 2-207(2).[61] Finally, there would be no need to distinguish between contracts formed through exchange of forms, conduct, or a combination of writings and conduct as currently envisioned by section 2-207(3).

D. *Summary*

Thus, the current practice of using unexamined forms to introduce uncustomary provisions must change. Formation should be treated as a separate issue from the determination of terms. If the parties manifest an intent to be bound, either through words or actions, then a contract is formed and welshing should not be permitted. The terms should be determined on the basis of those on which the parties negotiate or on which their forms agree, supplemented by default terms provided by Article 2's gap fillers including trade usage, course of performance, and course of dealing. If a party wants to propose an uncustomary term, such as a warranty disclaimer, it should not engage in the current practice of exchanging unread boilerplate. It must provide the courts with

---

58. *See generally* Baird & Weisberg, *supra* note 1, at 1260-61 (weighing the advantages and disadvantages of a conspicuousness requirement in this context).

59. Under this proposal, the shipping of goods is interpreted as an offer to contract based on agreed terms, matching terms, and gap fillers. If the receiving party takes delivery, then that offer is accepted. Hence, either party could avoid contract formation by expressly conditioning its form and then refusing to deliver or to take delivery.

60. This is the counteroffer riddle. *See supra* text accompanying note 35.

61. Our proposal would also remove the present incentive to draft long and detailed form contracts. Under current law, reciting all U.C.C. gap fillers in one's form is well advised. Since it is harder to introduce "different" terms into a contract than it is to include "additional" terms, it is important to make sure customary as well as non-customary terms appear on one's form. Under our proposal, the only terms needed on a standardized form are those terms that contradict custom. There would be no advantage in reciting U.C.C. gap fillers chapter and verse. This should help the parties maintain the advantages of form contracting while simultaneously empowering them to craft their own exchange.

more evidence than its own form coupled with an accepted delivery; it must also show that the term was subjectively agreed to by the other party. If an uncustomary term is reasonable, then that meaningful consent should be easily obtained. Finally, the counteroffer riddle should be resolved in favor of Code gap fillers. Such an approach would be both just and economically efficient.

III. APPLYING THE ECONOMIC APPROACH TO PROPOSED SECTION 2-207

The Proposed section 2-207, as part of the larger revision of Article 2 by the National Commission of Uniform State Laws, incorporates much of the approach suggested in the prior section. In 1988, the Commission formed a study group that issued its first report in 1990.[62] A task force addressed the issues presented in the 1990 report, and its critique was published, along with the 1990 report, in 1991.[63] Further discussions and revisions resulted from a 1993 review.[64] In 1994, the National Commission conducted a first reading of the proposed revision and conducted extensive discussions.[65] A final proposal is not expected until 1996 or 1997.[66]

The above mentioned process involved several revisions to proposed section 2-207. The Study Group's initial suggestion followed the general structure proposed by John Murray in a pair of 1986 articles.[67] The 1991 task force criticized the complexity of that approach and the abandonment of the structure of the existing section 2-207, which the task force felt worked in a majority of situations.[68] The version produced in 1993 took on a more mechanical nature with the careful identification of formation and term issues.[69] The version discussed in 1994 further refined the language of the 1993 version and reorganized its sections.[70]

---

62. McCarthy, *supra* note 1, at 1020 n.5.

63. *An Appraisal of the March 1, 1990, Preliminary Report of the Uniform Commercial Code Article 2 Study Group*, 16 DEL. J. CORP. L. 981 (1991) [hereinafter *Preliminary Report*].

64. McCarthy, *supra* note 1, at 1020.

65. *Proceedings in the Committee of the Whole, Uniform Commercial Code, Article 2, Sales*, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS (1994) (Chicago, Ill., July 29-Aug. 4) [hereinafter *Proceedings*].

66. Zan Hale, *UCC Article 2 Drafting Committee Faces Critics*, CORP. LEGAL TIMES, Oct. 1994, at 24. The changes discussed in this section are one part of a significant proposed redesign of Article 2 to accommodate the growth of leasing and sale of software as well as to revise problematic sections of the existing Article 2. *See* Raymond T. Nimmer, *Intangibles Contracts: Thoughts of Hubs, Spokes, and Reinvigorating Article 2*, 35 WM. & MARY L. REV. 1337 (1994).

67. *Preliminary Report*, *supra* note 63, at 1056 (citing Murray, *supra* note 1; Murray *Chaos*, *supra* note 1). For further discussion of the *Preliminary Report*, see Alex Devience, Jr., *The Recommendations to Revise Article 2*, 24 UCC L.J. 349, 352 (1992) (suggesting that the changes reflect a broader agenda to weaken the traditional approach to formation and move the Article toward principles consistent with the *Restatement (Second) of Contracts*).

68. *Preliminary Report*, *supra* note 63, at 1056-57.

69. Richard E. Speidel, *Contract Formation and Modification Under Revised Article 2*, 35 WM. & MARY L. REV. 1305, 1325 (1994).

70. For the text of the 1994 revision, see *infra* text accompanying note 71.

A. *The Battle of Forms Revision: Circa 1994*

The 1994 revision separates the problems of formation and terms into different sections of the Code. Sections 2-204 and 2-206 provide the basis for finding a contract. Section 2-207 describes the process for determining the terms of the contract.

The formation provisions direct the parties and courts to look for the existence of the contract without reference to the niceties of common law offer and acceptance rules, and they rejected the mirror image rule. Proposed section 2-204 provides:

> (a) A contract for sale may be made in any manner sufficient to manifest agreement, including offer and acceptance and conduct by both parties recognizing the existence of the contract.
>
> (b) If the parties so intend, an agreement is sufficient to make a contract for a sale even if the moment of the making of the agreement is not determined, one or more terms are left open or to be agreed upon, or writings or records of the parties contain varying terms as defined in Section 2-207(a).
>
> (c) If a contract for sale is made and one or more terms in the agreement are left open, the contract does not fail for indefiniteness if there is a reasonably certain basis for an appropriate remedy.[71]

Section 2-206 further provides:

> (a) Unless otherwise unambiguously indicated by the language or circumstances:
>
> > (1) an offer to make a contract must be construed as inviting acceptance in any manner and by any medium reasonable under the circumstances including an expression of assent which contains varying terms as defined in Section 2-207(a).
> >
> > (2) an order or other offer to buy goods for prompt or current shipment must be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming goods. However, a shipment of nonconforming goods is not an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.
>
> (b) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.[72]

---

71. *Proceedings, supra* note 65, at 56. The first reading of § 2-204 produced no comments from the attending commissioners. *Id.*

72. *Id.* at 58. The first reading of § 2-206 produced no comments from the attending commissioners. *Id.* at 59.

The effect of the two sections is to remove the constraints of the traditional rules of offer and acceptance. This result is achieved in several ways. First, pursuant to section 2-204(a), circumstances demonstrating the existence of a contract are expanded beyond the traditional model of a negotiated offer and acceptance to include the parties' conduct. Second, section 2-204(b) references the intent of the parties which would presumably include the customary understandings associated with the transaction. More importantly for the battle of forms problem, under section 2-204(c), the terms of the offer and acceptance need not agree if the parties' intent demonstrates the existence of a contract. Welshing would not be permitted. This provision is an obvious rejection of the mirror image rule.

The demise of the mirror image rule is carried out in the determination of the terms of the contract created by a mixture of conduct and other actions. If the parties intended to contract, then the terms may be determined under proposed section 2-207. That section provides:

> (a) In this article, "varying terms" means terms prepared by one party and contained in a standard form writing or record.
>
> (b) If an agreement of the parties contains varying terms, a contract results if Sections 2-204 and 2-206 are satisfied.
>
> (c) Varying terms contained in the writings and other records of the parties do not become part of the contract unless the party claiming inclusion proves that the party against whom they operate expressly agreed to the terms or assented to and had notice of the terms from trade usage, previous course of dealing or course of performance. Between merchants, the burden of proof is by a preponderance of evidence. Otherwise, it is by clear and convincing evidence.
>
> (d) If a contract with varying terms is formed under subsection (a), the terms are:
>
> (1) terms upon which the writings or records agree;
>
> (2) terms varying terms [sic] included under subsection (c);
>
> (3) terms to which the parties have otherwise agreed; and
>
> (4) any supplementary terms incorporated under any other provisions of this [Act].[73]

This revision constitutes a significant change from existing law in that it rejects the distinction between additional and different terms, drops the "unless proviso" that has become the basis of modern form drafting,[74] and eliminates the convoluted parsing necessary for determining the fate of additional terms.[75]

---

73. *Id.* at 59-60.

74. McCarthy, *supra* note 1, at 1022.

75. The complexity and inconsistency of § 2-207 decisions have led proponents of some variation of the existing statute to suggest that this complexity has allowed the courts to do justice in particular cases. *Preliminary Report*, *supra* note 63, at 1062. We do not attempt to enter that particular fray. Some have suggested that the criticism is to hide a more broadly based concern

B. *Critiquing Proposed Sections 2-204, 2-206, and 2-207*

The proposed sections reflect many of the elements suggested by the economic approach to the battle of the forms. Both the treatment of formation issues and the manner of determining contractual terms tend to contemplate a solution that is consistent with the goals of autonomy, reduction of transaction costs, and stability. Hence, the revision is a major step in the right direction. Further refinements, however, could improve the final product.

Proposed sections 2-204 and 2-206 largely conform with our economic model. Instead of emphasizing a moment in time when the proper formalities are accomplished, the proposed sections ignore the sequential trading of forms in favor of the substance of formation as demonstrated by the content of the forms and the actions of the parties. The approach serves the principles of autonomy and freedom to contract, and reduces the potential of costly opportunism through welshing.

Yet a troublesome formation issue remains. Under the current section 2-207(1), a "definite expression of acceptance" forms an agreement, unless the acceptance is made "expressly conditional." Distinguishing a definite expression of acceptance from an expressly conditional one has proven particularly difficult for the courts and has generated a good deal of private gamesmanship.[76] The proposed treatment deletes the expressly conditional language of current law in favor of the language of section 2-206(a). It provides: "Unless otherwise unambiguously indicated by the language or circumstances: (1) an offer to make a contract must be construed as inviting acceptance in any manner and by any medium reasonable under the circumstances." Our fear is that the interpretation of "unless otherwise unambiguously indicated" may prove just as troublesome as interpreting the current term "unless expressly conditional."

Our proposed solution is to construct a "safe harbor" through which a party could "unambiguously indicate" that its attempt to contract is conditional on the agreement of the parties to that party's terms. One alternative is to include a provision that creates a boilerplate set of requirements that notify the other party of the intent of the initiating party.[77] Alternatively, this could be achieved through an official comment. Either approach would specify particular language unambiguously indicating that a party does not intend to be bound unless its uncustomary terms are expressly agreed to. The provision or comment should also provide that such language be "conspicuous." A party that used such conspicuous language would know that no express contract

---

that any alternative that results in the explicit recognition of using gap fillers would result in contracts that are unfair to vendors. Roszkowski & Wladis, *supra* note 1, at 1068-70.

76. By "gamesmanship" we refer to the practice of each party drafting a clause that states the terms on its form must control and no others, and that shipment or taking delivery constitutes acceptance of these terms. *See supra* note 34 and accompanying text. Armed with such a clause, parties have an incentive to additionally "game" the system by being the last party to send a form. *See supra* text accompanying note 35.

77. An example of this approach is taken in U.C.C. § 2-719 (West 1995). In this section, the seller must indicate that the intended remedy is exclusive. Similarly, under § 2-316(2), an attempt to disclaim a warranty of fitness for a particular purpose must be in writing and conspicuous.

would be formed on the exchange of conflicting forms. In effect, it would expressly reserve the right to welsh. A party using such language would also know that it should not deliver goods or take delivery of goods until the uncustomary language is expressly agreed to by its trading partner.

Proposed section 2-207 also seems to follow our economic prescriptions. The statute plainly rejects the possibility of surprising the parties with unbargained for terms by defining the terms of the agreement to be those terms that the parties expressly agree to, either in their forms or otherwise, and those terms provided by the U.C.C.[78] Varying terms on the forms (including different and additional terms identified by comparing the forms)[79] must be agreed to or the party must have notice and must have provided some prior assent to the term before it is included in the contract. Hence, proposed section 2-207 eliminates the need to distinguish between offeror or offeree, between material and non-material terms, or between additional and differing terms.

The goal of providing freedom to and from contract is enhanced by this approach. In general, parties are bound only to the terms to which they agree and those terms provided by statute and custom as defaults for terms that are not properly resolved by agreement. Moreover, transaction costs are reduced in those instances in which the forms do not agree by the provisions directing the inclusion of the U.C.C.'s supplementary terms. Since a supplementary term will always enter unless it is expressly negated through mutual agreement, there is no need to provide customary terms in one's boilerplate. Such forms should become much shorter and easier to use. Conspicuously conditional language would point the parties to the need to negotiate for different terms if they desire a different result (consistent with concerns for autonomy). Finally, reliance on supplementary terms assures a level of stability in those instances when the parties fail to define the particular terms in their agreement. In effect, the default terms are provided by the U.C.C. The parties may alter them, but if they fail to do so, the U.C.C. provides the terms for them.

Notwithstanding the virtues of proposed section 2-207, two problems are apparent. First, the counteroffer riddle needs to be treated more directly. The simple case is suggested by a traditional offer to buy that is limited by its terms to that offer. The seller rejects the uncustomary terms reflected in the offer, but nonetheless ships the goods and the buyer takes delivery. Under section 2-207(c), the "varying terms" of the offer are not expressly agreed to, so they do not become part of the contract. Under section 2-207(d), however, terms to which the parties have "otherwise agreed" do enter the agreement. One could argue that shipment reflects agreement to the uncustomary terms of the offer. To compound matters, proposed section 2-206 specifies that an offer to buy is accepted by shipment, but does not specify whether uncustomary terms in such an offer become part of the agreement. Perhaps this is not a case involving section 2-207 at all, but merely is an offer that has been accepted in its entirety by performance. This result, however, presents the parties

78. *Proceedings, supra* note 65, at 59-60.
79. *But see infra* text accompanying notes 82-83.

with a return to the last hit rule; the last party to send a form gets its terms by wrapping the offer or acceptance in nonnegotiated language.

Reading the proposed sections in their entirety suggests that the redrafting committee intends to resolve the counteroffer riddle in favor of supplementary terms. This is also the solution suggested by our economic tenets. Again, an official comment should specifically address the counteroffer riddle. The comment should state that an uncustomary term appearing on a standardized form will never enter a contract unless it matches express language on the other party's form or has been *expressly* agreed to by both parties.[80] Merely shipping goods or taking delivery is not sufficient evidence that uncustomary language has been subjectively agreed to.

The second problem with proposed section 2-207 is similar in nature. As noted before,[81] the mere agreement of forms on a particular term may not indicate actual agreement of the parties. For example, the forms may agree that the parties will arbitrate claims, but one form is premised on the availability of implied warranties while the other form disclaims them. Under these circumstances, the parties' forms would direct arbitration (pursuant to section 2-207(d)(1)), but the warranty may or may not be included. If there is no reason to include either term under subsection (c), the default term would be an implied warranty of merchantability. Under these circumstances, the injured party, likely the seller, would have arbitration, but not upon the circumstances that it bargained for. It never agreed to arbitrate a warranty. The only apparent solution is for the seller to incur additional costs to put the buyer on notice and attempt to negotiate a different deal. If the buyer refuses, the deal is lost and the seller should not deliver the goods. Again, considering the recurring nature of this "integration problem," an official comment indicating the preferred results seems appropriate.

In summary, the focus should be on finding those terms on which the parties agreed and determining the proper default terms based on the U.C.C. and the historical and industrial customs. The goal is to find agreement without forcing any surprising or unexpected terms on any party. Businesspersons will soon learn that uncustomary and surprising language will not enter an agreement simply by printing such language on an unread form. While at times this may work to the advantage of one party or the other, the solution for the disadvantaged party is to negotiate better terms than those provided in the existing contract, by the U.C.C., or by custom.

C. *Additional Drafting Problems of Proposed Section 2-207*

Despite the obvious strengths of the revision, several apparent drafting problems are likely to cause problems.[82] The first, and potentially most

---

80. In this context, express agreement is a necessary, but not sufficient, reason for an uncustomary term to enter the contract. Express language does not control if derived through duress, misrepresentation, or unconscionable business conduct.

81. *See supra* note 45.

82. In addition to the comments in the text, there were two identifiable drafting errors in the 1994 draft. The reference to subsection (a) in the opening clause of subsection (d) should read

significant, is the definition of varying terms found in section 2-207(a).[83] On its face, "varying" suggests the notion of difference or additional. The apparent goal was to find a term that encompassed both categories of terms under existing law without using the words "additional" or "different." That goal is understandable, given the semantic confusion created by the current language. The definition, however, states that it refers to terms prepared by one party and contained in a standard form. The meaning is clarified somewhat in subsections (b), (c), and (d), in which there is a suggestion that varying terms are those on which the forms do not agree. But even here the meaning is ambiguous, since varying terms are brought into the contract if they are agreed to or assented to with notice. In short, the definition of "varying" gives too little guidance about the kinds of terms that it is meant to address. This definitional problem is further complicated by the remaining subsections.[84]

Our proposed solution is to define varying terms as those terms prepared by one party and contained in a standard form writing or record that *vary from trade usage, previous course of dealing, course of performance, or any supplementary terms incorporated under any other provisions of Article 2*. The heart of the battle of forms problem is that unread boilerplate language can sometimes be used to introduce uncustomary (surprising) terms. Under our definition, it would be clear that where boilerplate conflicts and where both parties have suggested an uncustomary term, neither term would enter the contract; the court would supply a customary gap filler. If boilerplate conflicts, with one party suggesting an uncustomary term and the other reciting the customary treatment, then again, custom would control. In short, we believe that our definition would better capture the essence of the battle of forms problem and would also will harmonize well with the cross-references to section 2-207(a) contained in sections 2-204 and 2-206.

The use of the word "agreement" in subsection (b) raises a second drafting problem. First, it is not clear what agreement means.[85] This ambiguity is further complicated by the use of "contract" in the same subsection. It is far from clear what is meant by "agreement" when "contract" is defined by sections 2-204 and 2-206. The drafters were probably referring to the collective forms or records issued by the parties.[86] If so, then the phrase "forms or records issued by the parties" should replace the word "agreement."

Third, subsection (c) presents a difficulty by referring to "assented to" terms through notice of trade usage, previous course of dealing, or course of performance. The same sentence makes reference to "agreed . . . terms." Nowhere is there a suggestion of how an agreed term differs from an assented term, nor how assent and agreement to terms differ. The context of assent suggests a prior performance under the term, or an agreement with a similar

---

"subsection (b)" and the first use of "terms" in subsection (d)(2) should be removed. *Proceedings, supra* note 65, at 60, 64.

83. A discussion draft circulated in December, 1994 dropped the reference to "varying terms." Copy on file with the authors.

84. Roszkowski & Wladis, *supra* note 1, at 1077-78.

85. *Proceedings, supra* note 65, at 60.

86. *Id.*

term (course of dealing), but it is not clear whether that constitutes assent. The language does nothing to identify those instances in which the assent is effective to bring a varying term into the contract because assent itself is ambiguous.[87] The solution is to focus on actual agreement. We suggest placing a period after the phrase "expressly agreed to the terms," and deleting the phrase following the "or."

Fourth, subsection (d)(3) is not clear in its context. Subsection (d)(3) provides that the agreement includes "terms to which the parties have otherwise agreed." It would appear to apply to those terms that the parties orally agreed to but failed to include in the forms. This reading would be consistent, though redundant, with the notion that any agreed to terms are already incorporated into the contract by subsection (d)(1). More importantly, care must be taken to avoid resurrecting the counteroffer riddle through the language of (d)(3).[88] Varying terms (uncustomary boilerplate) contained in the "last form" should not be deemed accepted merely through conduct. To avoid this pitfall, we suggest inserting the word "expressly." The new language could read: "(d)(3) terms to which the parties have otherwise *expressly* agreed." Alternatively, a comment could clarify that the "terms" referenced in (d)(3) do not include "varying terms."

Finally, subsection (d)(4) should make explicit reference to usage of trade and course of performance as terms to be included in the contract as supplementary terms.[89] This is particularly true if the reference to usage of trade and course of performance is deleted from subsection (c) as suggested above. Currently, the section's simple reference to supplementary terms may suggest only those terms that are substantively described in the Article such as the warranty of merchantability. Anything that is not specifically set out might then be lost in the search to find a second step. On the other hand, if the section makes it explicit that these provisions are part of the contract by default, there will be added incentives for the parties to take any necessary steps to make clear their intent, thus stabilizing the relationship and avoiding the gamesmanship inherent in the current maze created by section 2-207.

Taken together, the critique and drafting suggestions would result in the following proposed redrafting of section 2-207:

> (a) In this Article, "varying terms" means terms prepared by one party and contained in a standard form writing or record that vary from trade usage, previous course of dealing, course of performance, or any supplementary terms incorporated under any other provisions of Article 2.
>
> (b) If an agreement of the parties contains varying terms, a contract results if sections 2-204 and 2-206 are satisfied.
>
> (c) Varying terms contained in the writings and other records of the parties do not become part of the contract unless the party claiming

87. Roszkowski & Wladis, *supra* note 1, at 1074.

88. Roszkowski and Wladis raise a similar concern in a prior version of proposed § 2-207 containing similar language. *Id.*

89. For a similar argument, see *id.* at 1074-75, 1078.

inclusion proves that the party against whom they operate expressly agreed to the terms. Between merchants, the burden of proof is by a preponderance of evidence. Otherwise, it is by clear and convincing evidence.

(d) If a contract with varying terms is formed under subsection (b), the terms are:

(1) terms upon which the writings or records agree;

(2) varying terms included under subsection (c);

(3) terms to which the parties have otherwise expressly agreed; and

(4) any supplementary terms, including those provided by previous course of dealing, course of performance, or usage of trade, incorporated under any other provisions of this [Act].

In addition, we recommend the inclusion of official comments that suggest the preferred outcomes to the counteroffer and integration problems noted before.

CONCLUSION

The proposed revisions to the battle of the forms make important steps toward remedying one of the most notorious problems under the current Article 2. The proposed approach to section 2-207 emphasizes the customary terms associated with the sales of goods. Such an approach is consistent with the vision initially offered by Karl Llewellyn, the chief draftsperson of Article 2. Llewellyn wrote that "the modern contract scholar's task is to find six to twelve transaction-types, to locate, describe, and test proper specifics for an iron core of exchange expectations."[90] Trade customs, previous course of dealing, course of performance, and the supplementary provisions of Article 2 provide these expectations. Pursuant to proposed section 2-207, unread boilerplate will no longer suffice to vary these expectations. Moreover, such an approach reflects sound economic reasoning based on the needs to preserve individual autonomy, reduce transaction costs, and provide legal stability.

90. KARL LLEWELLYN, THE COMMON LAW TRADITION 368-69 (1960).

LIMITED LIABILITY COMPANY INTERESTS AS SECURITIES: AN ANALYSIS OF FEDERAL AND STATE ACTIONS AGAINST LIMITED LIABILITY COMPANIES UNDER THE SECURITIES LAWS

ELAINE A. WELLE*

* Assistant Professor of Law, University of Wyoming College of Law. Member, Colorado Bar; B.A., University of Colorado, 1977; M.B.A., University of Colorado, 1981; J.D., University of Arizona, 1986. The author thanks Professor Harvey Gelb and Professor J. Robert Brown, Jr. for their helpful comments, and Professor Mark Sargent for his assistance in locating certain state authorities. The author gratefully acknowledges the research assistance of Teresa K. Jensen and Susan E. Schell, law students at the University of Wyoming, and the editorial assistance of the *Denver University Law Review* Board of Editors. The author also wishes to thank Teresa Nelson whose unbelievable skill, efficiency, and accuracy, together with good humor, helped to produce this work. Funding for this research was provided by a University of Wyoming College of Law George Hopper Faculty Research Fund grant.

I. INTRODUCTION

A limited liability company ("LLC") is a business entity intended to offer its owners the limited liability protection of a traditional corporation and the tax advantages of a partnership.[1] Although the Wyoming legislature enacted

1. For a comprehensive analysis of limited liability companies, including tax and business aspects, see LARRY E. RIBSTEIN & ROBERT R. KEATINGE, 1 RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES (1994 & Cum. Supp. 1995); MARK A. SARGENT & WALTER D. SCHWIDETZKY, LIMITED LIABILITY COMPANY HANDBOOK (1994-95) [hereinafter SARGENT HANDBOOK]; Allan G. Donn, *Practical Guide to Limited Liability Companies, in* 1 STATE LIMITED LIABILITY COMPANY & PARTNERSHIP LAWS at PGLLC-1 (Michael A. Bamberger & Arthur J. Jacobson eds., 1995-1 Supp.); Wayne M. Gazur & Neil M. Goff, *Assessing the Limited Liability Company*, 41 CASE W. RES. L. REV. 387 (1991); Thomas E. Geu, *Understanding the Limited Liability Company: A Basic Comparative Primer (Part One)*, 37 S.D. L. REV. 44 (1992); Thomas E. Geu, *Understanding the Limited Liability Company: A Basic Comparative Primer (Part Two)*, 37 S.D. L. REV. 467 (1992) [hereinafter Geu, Part Two]; Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375 (1992). A bibliography of

the first limited liability company statute in 1977,[2] few states followed until the Internal Revenue Service ruled in 1988 that LLCs would be treated like partnerships for tax purposes.[3] Forty-seven states and the District of Columbia now allow for the formation of LLCs,[4] and thousands have been formed in the last few years.[5]

Treatises, articles, and commentaries written about LLCs have focused primarily on the organizational, tax, and formation aspects of the entity.[6]

---

articles written about limited liability companies is set forth in Chapter 7 of the SARGENT HANDBOOK, *supra*.

2. Wyoming Limited Liability Company Act, ch. 158, 1977 Wyo. Sess. Laws 537 (codified as amended at Wyo. Stat. §§ 17-15-101 to -143 (1989 & Supp. 1994)).

3. Rev. Rul. 88-76, 1988-2 C.B. 360. Florida enacted LLC legislation in 1982, but few states followed Wyoming's and Florida's lead until Revenue Ruling 88-76 was announced. In 1990, Colorado and Kansas enacted LLC statutes and Indiana enacted a statute requiring foreign LLCs to register with the Indiana Secretary of State. In 1991, Nevada, Texas, Utah, and Virginia passed LLC legislation. By 1994, 43 states had enacted LLC statutes and six others were considering legislation. SARGENT HANDBOOK, *supra* note 1, § 1.02. For a discussion of the origins and pattern of LLC enactments, see SARGENT HANDBOOK, *supra* note 1, § 1.02; Keatinge et al., *supra* note 1, at 381-84.

4. For the text of many state limited liability company statutes, see 2-4 RIBSTEIN & KEATINGE, *supra* note 1, app. D; 2-5 STATE LIMITED LIABILITY COMPANY & PARTNERSHIP LAWS (Michael A. Bamberger & Arthur J. Jacobson eds., 1994 & 1995-2 Supp.). For a survey of the existing statutes and pending legislation, see SARGENT HANDBOOK, *supra* note 1, ch. 5. As of this writing, 47 states and the District of Columbia have adopted limited liability company statutes and the remaining states (Hawaii, Massachusetts, and Vermont) are considering adoption. ALA. CODE §§ 10-12-1 to -61 (1994); ALASKA STAT. §§ 10.50.010-.995 (Supp. 1994); ARIZ. REV. STAT. ANN. §§ 29-601 to -857 (Supp. 1994); ARK. CODE ANN. §§ 4-32-101 to -1316 (Michie Supp. 1993); CAL. CORP. CODE §§ 17000-17705 (West 1995); COLO. REV. STAT. ANN. §§ 7-80-101 to -1101 (West Supp. 1994); CONN. GEN. STAT. ANN. §§ 34-100 to -242 (West Supp. 1995); DEL. CODE ANN. tit. 6, §§ 18-101 to -1107 (1993 & Supp. 1994); D.C. CODE ANN. §§ 29-1301 to -1375 (Supp. 1995); FLA. STAT. ANN. §§ 608.401-.514 (West 1993 & Supp. 1995); GA. CODE ANN. §§ 14-11-100 to -1109 (1994 & Supp. 1995); IDAHO CODE §§ 53-601 to -672 (1994 & Supp. 1995); ILL. ANN. STAT. ch. 805, para. 180/1-1 to /1-60 (Smith-Hurd Supp. 1995); IND. CODE ANN. §§ 23-18-1-1 to -19 (Burns 1995); IOWA CODE ANN. §§ 490A.100-.1601 (West Supp. 1995); KAN. STAT. ANN. §§ 17-7601 to -7652 (Supp. 1994); KY. REV. STAT. ANN. §§ 275.001-.455 (Michie/Bobbs-Merrill Supp. 1994); LA. REV. STAT. ANN. §§ 12:1301-:1369 (West 1994); ME. REV. STAT. ANN. tit. 31, §§ 601-762 (West Supp. 1994); MD. CODE ANN., CORPS. & ASS'NS §§ 4A-101 to -1103 (1993 & Supp. 1994); MICH. COMP. LAWS ANN. §§ 450.4101-.5200 (West Supp. 1995); MINN. STAT. ANN. §§ 322B.01-.960 (West 1995); MISS. CODE ANN. §§ 79-29-101 to -1204 (Supp. 1994); MO. ANN. STAT. §§ 347.010-.740 (Vernon Supp. 1995); MONT. CODE ANN. §§ 35-8-101 to -1307 (1993); NEB. REV. STAT. §§ 21-2601 to -2653 (Supp. 1994); NEV. REV. STAT. ANN. §§ 86.010-.571 (Michie 1994); N.H. REV. STAT. ANN. §§ 304-C:1 to :85 (1995); N.J. STAT. ANN. §§ 42:2B-1 to -70 (West Supp. 1995); N.M. STAT. ANN. §§ 53-19-1 to -74 (Michie 1993 & Supp. 1995); N.Y. LTD. LIAB. LAW §§ 101-1403 (McKinney Supp. 1995); N.C. GEN. STAT. §§ 57C-1-01 to -10-07 (1993 & Supp. 1994); N.D. CENT. CODE §§ 10-32-01 to -155 (1995); OHIO REV. CODE ANN. §§ 1705.01-.58 (Anderson Supp. 1994); OKLA. STAT. ANN. tit. 18, §§ 2000-2060 (West Supp. 1995); OR. REV. STAT. §§ 63.001-.990 (1995); 15 PA. CONS. STAT. ANN. §§ 8901-8998 (1995); R.I. GEN. LAWS §§ 7-16-1 to -75 (1992 & Supp. 1994); S.C. CODE ANN. §§ 33-43-101 to -1409 (Law. Co-op. Supp. 1994); S.D. CODIFIED LAWS ANN. §§ 47-34-1 to -59 (Supp. 1995); TENN. CODE ANN. §§ 48-201-101 to -248-606 (Supp. 1994); TEX. REV. CIV. STAT. ANN. art. 1528n (West Supp. 1995); UTAH CODE ANN. §§ 48-2b-101 to -158 (1994 & Supp. 1995); VA. CODE ANN. §§ 13.1-1000 to -1073 (Michie 1993 & Supp. 1995); WASH. REV. CODE §§ 25.15.005-.902 (West Supp. 1995); W. VA. CODE §§ 31-1A-1 to -69 (Supp. 1995); WIS. STAT. ANN. §§ 183.0102-.1305 (West 1994); WYO. STAT. §§ 17-15-101 to -144 (1989 & Supp. 1995).

5. John R. Emshwiller, *New Kind of Company Attracts Many—Some Legal, Some Not*, WALL ST. J., Nov. 8, 1993, at B1.

6. *See supra* note 1. For helpful background material refer to sources listed *supra* note 1,

Comparatively few authors, however, have addressed whether LLC interests should be considered securities. Those who have are divided on the issue of whether LLC interests should be treated as securities.[7]

While commentators continue to debate whether LLC interests should be treated as securities, the Securities and Exchange Commission ("SEC") and a number of state securities regulators have taken action. On March 24, 1994, the SEC filed a complaint in the United States District Court for the District of Columbia against Vision Communications, Inc. and several related parties.[8] The SEC alleged that the defendants violated the antifraud, securities registration, and broker-dealer registration provisions of the federal securities laws by selling membership units in a limited liability company.[9] By the summer of 1995, the SEC had filed complaints against defendants in at least six unrelated actions also alleging violations of the federal securities laws for selling interests in limited liability companies.[10] An attorney with the SEC Division of

---

and see Limited Liability Company Bibliography in Chapter 7 of the SARGENT HANDBOOK, *supra* note 1, at 7-1 to 7-6.

7. Treatises, articles, and commentaries addressing whether LLC interests constitute securities include 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-5 (proposing that there should be at least a presumption against a "security" characterization for LLC interests or LLC interests might be characterized as nonsecurities because LLC interests are closely held); MARK A. SARGENT, LIMITED LIABILITY COMPANY HANDBOOK ch. 3 (1993-94) (concluding that LLC interests are not securities in most instances); Donn, *supra* note 1, § 3.4, at PGLLC-16 (noting that the determination depends on the circumstances of the particular case); S. Brian Farmer & Louis A. Mezzullo, *The Virginia Limited Liability Company Act*, 25 U. RICH. L. REV. 789, 828-30 (1991) (suggesting courts will find an LLC interest a security if it satisfies the definition of investment contract); Geu, Part Two, *supra* note 1, at 510-18, 520 (observing that there is no bright line test and suggesting a case-by-case analysis depending on the organization and operating agreement); Carol R. Goforth, *Why Limited Liability Company Membership Interests Should Not Be Treated as Securities and Possible Steps to Encourage this Result*, 45 HASTINGS L.J. 1223 (1994) (arguing an LLC interest should not be treated as a security); Keatinge et al., *supra* note 1, at 403-04 (stating that the critical question is "whether profits are expected 'from the efforts of the promoter or a third party'"); Joseph C. Long, *Cellular Telephone and Wireless Cable Interests as Investment Contracts*, 1 Enforcement L. Rep. 86, 110-14 (1993) (stating that a unit in an LLC can be an investment contract and therefore a security); John A. Peralta, *Limited Liability Company Interests as Securities*, 1 Enforcement L. Rep. 29, 36 (1993) (LLC interests are usually securities); Larry E. Ribstein, *Form and Substance in the Definition of a "Security": The Case of Limited Liability Companies*, 51 WASH. & LEE L. REV. 807 (1994) (urging courts to hold that an interest in an LLC is presumptively not a security); Mark A. Sargent, *Will Limited Liability Companies Punch a Hole in the Blue Sky?*, 21 SEC. REG. L.J. 429, 439-40 (1994) (proposing that evaluation should be on a case-by-case basis, without a presumption that LLC interests are securities) [hereinafter Sargent Blue Sky]; Mark A. Sargent, *Are Limited Liability Company Interests Securities?*, 19 PEPP. L. REV. 1069 (1992) (arguing that LLC interests normally do not satisfy the definition of a security) [hereinafter Sargent Article]; Marc I. Steinberg & Karen L. Conway, *The Limited Liability Company as a Security*, 19 PEPP. L. REV. 1105 (1992) (arguing that LLC interests normally are securities) [hereinafter Steinberg Article].

8. *See* SEC v. Vision Communications, Inc., Litigation Release No. 14026, 56 SEC Docket 880, 1994 WL 96945 (SEC) (Mar. 24, 1994); *Civil Action Against Vision Communications, Inc.*, SEC News Digest 94-56-4, 1994 WL 94496 (SEC) (Mar. 25, 1994); *SEC Enforcement: Alleged Boiler Room Sales of Interests in Cable Venture Subject to SEC Suit*, Sec. L. Daily (BNA) (Mar. 28, 1994); *Alleged Boiler Room Sales of Interests in Cable Venture Subject of SEC Suit*, Sec. Reg. & L. Rep. (BNA) No. 26, at 662 (May 6, 1994).

9. SEC v. Vision Communications, Inc., Litigation Release No. 14026, 56 SEC Docket 880, 1994 WL 96945 (SEC) (Mar. 24, 1994).

10. SEC v. Irwin Harry Bloch, Litigation Release No. 14511, 59 SEC Docket 931, 1995 WL 317420 (SEC) (May 25, 1995); SEC v. United Communications, Ltd., Litigation Release No. 14477, 59 SEC Docket 424, 1995 WL 254714 (SEC) (Apr. 24, 1995); SEC v. American Interac-

Enforcement stated that the SEC was evaluating a number of LLC operations to determine whether such organizations were violating federal securities laws.[11]

At least sixteen states have taken action under state securities laws against entities offering or selling LLC interests.[12] In at least twelve states, state courts or regulators have ordered LLC promoters to cease and desist from offering or selling LLC interests in violation of state securities laws, based on findings of sufficient evidence to conclude such LLC interests were securities.[13] In addition, a number of jurisdictions have adopted legislation that either expressly states or implies that LLC interests are securities. For example, the legislatures in eight states amended their securities laws to expressly state that certain LLC interests may be securities.[14] The legislatures in seven states have amended their securities law statutes to include references to LLCs.[15]

---

tive Group, LLC, Litigation Release No. 14462, 59 SEC Docket 203, 1995 WL 229088 (SEC) (Apr. 10, 1995); SEC v. Future Vision Direct Mktg., Inc., Litigation Release No. 14384, 58 SEC Docket 1716, 1995 WL 25731 (SEC) (Jan. 18, 1995); SEC v. Parkersburg Wireless Ltd. Liab. Co., Litigation Release No. 14085, 56 SEC Docket 1974, 1994 WL 186833 (SEC) (May 16, 1994); *Commission Obtains TRO Against Knoxville, LLC*, SEC News Dig. 94-130-10, 1994 WL 328317 (SEC) (July 12, 1994). For a discussion of such actions see part II.A.

11. John R. Emshwiller, *SEC Sets Sights on Certain Limited Liability Companies*, WALL ST. J., Mar. 31, 1994, at B2.

12. Emshwiller, *supra* note 5. In November 1993, an article in the *Wall Street Journal* stated that at least 16 states had filed legal actions against a variety of wireless cable and related communications technology firms on the grounds that they had violated securities laws by offering or selling LLC interests. *Id.*

13. Orders have been issued under the securities laws of Colorado, Georgia, Illinois, Indiana, Kansas, Minnesota, Missouri, North Dakota, Pennsylvania, South Dakota, Washington, and Wisconsin. Many are summary cease and desist orders. Some of these orders are available on either Westlaw or Lexis. Unfortunately, many trial and administrative decisions are unreported. For example, California and New York courts, as well as federal courts, frequently do not publish their securities opinions. JOSEPH C. LONG, 12 BLUE SKY LAWS xi (1995). As a result, there may be numerous orders relating to alleged violations of state securities laws for the offer and sale of LLC interests that are not reported.

Table I of this article contains a summary of the various state actions either declaring that LLC interests are securities or indicating that LLC interests may be securities. Table I is organized by state and by case and provides the citation to each case. Table I sets forth the state action taken, the securities law violations raised, and the securities law theories discussed. Finally, Table I indicates whether the action was a summary order, or whether it resulted in written findings of fact, conclusions of law, or an opinion.

14. ALASKA STAT. § 45.55.990(12) (1994); CAL. CORP. CODE § 25019 (West Supp. 1995); IND. CODE ANN. § 23-2-1-1(k) (West 1995); N.M. STAT. ANN. § 58-13B-2(V) (Michie Supp. 1995); OHIO REV. CODE ANN. § 1707.01(B) (Baldwin Supp. 1995); PA. STAT. ANN. tit. 70, § 1-102(t) (Supp. 1995); VT. STAT. ANN. tit. 9, § 4202a(14) (Supp. 1995); WIS. STAT. ANN. § 551.02(13)(c) (West Supp. 1995). Table II of this article contains a listing of the state statutes that expressly address whether LLC interests are securities under state law. Table II is organized alphabetically by state and provides the statutory citation, a short summary of the statutory provision, and the relevant statutory language.

15. For example, the following state securities laws include references to LLCs: CONN. GEN. STAT. ANN. § 36b-1 (West Supp. 1995) (general statement); IOWA CODE ANN. § 502.207A(2)(a) (West Supp. 1995) (expedited registration by filing for small issuers); KAN. STAT. ANN. § 17-1262(l) (Supp. 1994) (exempt transactions); LA. REV. STAT. ANN. § 51:709(12) (West Supp. 1995) (exempt transactions); N.H. REV. STAT. ANN. § 421-B:11(II) (Supp. 1994) (registration requirement); N.H. REV. STAT. ANN. § 421-B:13(I) (Supp. 1994) (registration by coordination); N.H. REV. STAT. ANN. § 421-B:17(II)(k) (Supp. 1994) (registration exemption); N.D. CENT. CODE § 10-04-05(4), (10), (11), (13) (1995) (exempt securities); N.D. CENT. CODE § 10-04-06(4), (6), (10), (14) (1995) (exempt transactions); N.D. CENT. CODE § 10-04-07(2)(b)(3) (1995) (registration

These references imply that the offer and sale of LLC interests are subject to such securities laws.[16] The legislatures in four states included provisions in their limited liability company acts that raise the securities law issue.[17] Additionally, a 1993 survey of state securities regulators indicated that twenty-four states had taken the position, either formally or informally, that LLC interests may be securities under their state securities laws.[18] A more recent survey of state laws, regulations, and securities administrators indicates that now at least thirty-five states have taken that position, either formally or informally.[19]

The outcome of federal and state LLC securities litigation, together with the various legislative measures, is of great practical importance to practitioners. If an LLC interest is a security, it triggers, among other things, securities registration requirements, broker-dealer registration requirements, securities fraud liability, and in some cases disclosure obligations.[20] The SEC, state securities commissioners, and private parties[21] may bring suit for securities law violations. Criminal liability may even be imposed under certain circumstances.

Absent legislative action, many LLC ownership interests probably will not be deemed securities. It is highly unlikely that courts will hold ownership interests in all LLCs are per se securities. Nevertheless, based on the litigation to date, it appears highly likely courts will hold that ownership interests in LLCs with certain characteristics are securities.[22] As a result, the structure of an LLC may determine whether an ownership interest is a security.

Part II of this article provides an overview of the current federal and state LLC securities litigation. It describes the types of offerings targeted by the government and outlines the common characteristics these LLC entities allegedly share. Part III analyzes the various theories asserted by commentators, federal regulators, and state regulators to bring such LLC offerings within the

---

by description); VA. CODE ANN. § 13.1-514(B)(7)(b) (Michie Supp. 1995) (exempt transactions).

16. *See supra* note 15.

17. GA. CODE ANN. § 14-11-1107(n) (1994) provides, "[n]othing in this chapter shall be construed as establishing that a limited liability company interest is not a 'security'. . . ." MICH. COMP. LAWS ANN. § 450.5103 (West Supp. 1995) provides, "[a]n interest in a limited liability company to which this act applies is a security to the same extent as an interest in a corporation, partnership, or limited partnership is a security." MO. ANN. STAT. § 347.185 (Vernon Supp. 1995) states, "[i]t shall be rebuttably presumed that a member's interest in a limited liability company in which management is not vested in one or more managers is not a security for purposes of any and all laws of this state regulating the sale or exchange of securities." WIS. STAT. ANN. § 183.1303 (West Supp. 1995) provides, "[a]n interest in a limited liability company may be a security . . . ."

18. *See* Sargent Blue Sky, *supra* note 7, at 430-35.

19. *See* 1 Blue Sky L. Rep. (CCH) ¶ 6551; *see also* Tables I, II, and III, *infra*, pp. 495-505.

20. *See* 1 RIBSTEIN & KEATINGE, *supra* note 1, §§ 14.02-14.03, at 14-6 to 14-12 (describing federal and state requirements).

21. The author found only one reported case in which private parties alleged violations of the securities laws in connection with the purchase or sale of an LLC interest. *See* Fransen v. Terps Ltd. Liab. Co., 153 F.R.D. 655 (D. Colo. 1994) (seeking damages for violation of federal and state securities laws in connection with the sale of membership interests in an LLC) (summary judgment granted for defendants on other grounds). Although there are few reported cases, from discussions with practitioners it appears that private parties are beginning to raise and litigate such securities law claims.

22. *See* discussion *infra* parts III.A, III.B, and III.E.

ambit of the securities laws. These theories include the investment contract theory, risk capital analysis, the characteristics of stock test, the commonly known as a security test, and state statutory grounds. Part III also presents possible defenses to each of these theories. The discussion of each theory concludes with the author's evaluation of the theory's applicability, and an assessment of the arguments asserted and the defenses presented. Part IV summarizes the analysis of these theories and discusses the author's conclusions.

II. BACKGROUND ON FEDERAL AND STATE ACTIONS

Federal and state actions against LLC offerings have focused primarily on entities selling interests in so-called "wireless cable"[23] and related communications technology.[24] Although such actions have been directed at wireless communications companies, these cases indicate: (1) the type of LLC offering the government is targeting; (2) the common characteristics these offerings allegedly share; and (3) the types of claims raised by the government. But even more importantly, these cases dispel certain myths and misconceptions about LLCs.

For example, commentators have argued that LLC interests should not be treated as securities because LLCs generally are closely held and member-managed.[25] They maintain that since most LLC members are actively engaged in the management of the LLC, such investors are not dependent on the efforts of others and therefore are not in need of the protection provided by the securities laws.[26] They contend that LLC interests should not be treated as securities because LLCs resemble general partnerships.[27] General partnership interests are presumed not to be securities because each partner retains control over the management of the partnership.[28]

The federal and state actions against LLCs illustrate that not all LLCs are closely held or member-managed. In fact, some LLCs have hundreds of members.[29] These cases demonstrate that many LLC promoters have mass-market-

---

23. Wireless cable, also known as Super High Frequency Television ("SHFTV"), refers to a method of transmitting video entertainment programming through the use of microwave radio technology. SHFTV is a new broadcast system that uses microwave technology to transmit up to 32 video channels from a transmitter antenna to small rooftop antennas where signals are received and sent to television sets for viewing. SHFTV technology allows wireless networks to broadcast television programming similar to that offered by cable television companies. *See* Plaintiff Securities and Exchange Commission's Memorandum of Points and Authorities in Support of its Motion for Temporary Restraining Order, Preliminary Injunction and Other Relief at 3 n.2, SEC v. Vision Communications, Inc., No. 94-0615 (CRR), 1994 WL 326868 (D.D.C. May 11, 1994) [hereinafter Plaintiff's Memorandum in Vision].

24. *See, e.g., infra* Table I pp. 495-98 (19 of the 23 state actions cited involve companies in the telecommunications business).

25. *See, e.g.*, 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-5; SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-10 to 4-13.

26. *See, e.g.*, 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-5 to 14-6.

27. *See, e.g.*, 1 *id.* at 14-4; SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-10 to 4-11.

28. *See, e.g.*, Youmans v. Simon, 791 F.2d 341, 346 (5th Cir. 1986); Williamson v. Tucker, 645 F.2d 404, 424 (5th Cir.), *cert. denied*, 454 U.S. 897 (1981).

29. *See, e.g.*, Plaintiff's Memorandum in Vision at 2, 7, 1994 WL 326868 (No. 94-0615); Plaintiff Securities and Exchange Commission's Memorandum of Points and Authorities in Sup-

ed LLC offerings indiscriminately to the general public, using telemarketing techniques, promotional mailings, and even television infomercials to induce financially unsophisticated individuals to invest their retirement funds in LLC ventures.[30] The SEC and state regulators allege that such LLC investors often have no practical control over their investment due to the number of investors, the relatively small size of each investment, the geographic dispersion of the investors, and the lack of sophistication of the typical investor.[31] Such investors appear to be precisely the type of investors the securities laws were designed to protect.

Prosecutors have targeted primarily LLC investment opportunities which allegedly involved a relatively high degree of risk and were mass-marketed to unsophisticated investors using high pressure sales techniques and claims of immediate and exorbitant returns.[32] Admittedly, these egregious cases are not representative of all LLCs, but they clearly demonstrate the inaccuracy of common assumptions and generalizations that all LLCs are closely held and member-managed. The following is an overview of several selected cases that briefly describes the characteristics of these offerings, the claims raised by the government, the defenses presented by promoters, and the status of the litigation to date.

A. *Federal Cases*

1. *Vision Communications*

On March 24, 1994, the SEC filed suit against Vision Communications, Inc., Wilkes-Barre-Scranton L.C., and two individual defendants.[33] *SEC v. Vision Communications, Inc.*[34] was the first case in which the SEC sought a judgment under the federal securities laws in connection with the offer and sale of LLC interests.[35] The case raised an issue of first impression[36] in the federal courts: whether an LLC interest was a security and therefore subject to federal securities laws.

---

port of Its Motion for Temporary Restraining Order, Preliminary Injunction and Other Relief at 2, SEC v. Parkersburg Wireless Ltd. Liab. Co., (No. 94-1079) (SSH) (D.D.C. May 16, 1994) [hereinafter Plaintiff's Memorandum in Parkersburg].

30. *See, e.g.*, Plaintiff's Memorandum in Vision at 2, 4-6, 1994 WL 326868 (No. 94-0615); Plaintiff Securities and Exchange Commission's Reply Memorandum in Support of its Motion for Temporary Restraining Order at 3-4, SEC v. Vision Communications, Inc., No. 94-0615 (CRR), 1994 WL 326868 (D.D.C. May 11, 1994) [hereinafter Plaintiff's Reply Memorandum in Vision]; Plaintiff's Memorandum in Parkersburg at 2, 5, 7-8, 15, (No. 94-1079).

31. *See, e.g.*, Plaintiff's Memorandum in Vision at 13, 1994 WL 326868 (No. 94-0615); Plaintiff's Memorandum in Parkersburg at 15-16, (No. 94-1079).

32. *See supra* note 30.

33. SEC v. Vision Communications, Inc., Litigation Release No. 14026, 56 SEC Docket 880, 1994 WL 96945 (SEC) (Mar. 24, 1994).

34. SEC v. Vision Communications, Inc., No. 94-0615 (CRR), 1994 WL 326868 (D.D.C. May 11, 1994).

35. Emshwiller, *supra* note 11.

36. *See* Defendants' Memorandum of Points and Authorities in Opposition to Plaintiff's Motion for Temporary Restraining Order at 12-14, SEC v. Vision Communications, No. 94-0615 (CRR), 1994 WL 326868 (D.D.C. May 11, 1994) [hereinafter Defendants' Memorandum in Vision].

The defendants in *Vision Communications* purportedly were developing a wireless cable television system.[37] They claimed to be selling interests in an LLC to raise capital to obtain a license to install, operate, and market a super-high-frequency-television system, or to purchase an interest in such a system in the Wilkes-Barre-Scranton, Pennsylvania area.[38]

The SEC alleged several violations of the federal securities laws. First, the SEC maintained that membership units in the LLC constituted investment contracts and as such were securities under the Securities Act of 1933[39] ("Securities Act") and the Securities Exchange Act of 1934[40] ("Exchange Act").[41] Second, the SEC charged that the defendants offered and sold these unregistered securities in violation of sections 5(a) and 5(c) of the Securities Act.[42] Third, the SEC asserted that the defendants engaged in the business of selling the securities without registration as broker-dealers in violation of section 15(a) of the Exchange Act.[43] Finally, the SEC alleged that the defendants made false and misleading statements about the LLC and its business prospects in violation of section 17(a) of the Securities Act,[44] section 10(b) of

---

37. Plaintiff's Memorandum in Vision at 3, 1994 WL 326868 (No. 94-0615).
38. *Id.* at 3, 5.
39. 15 U.S.C. § 77a-77aa (1994).
40. 15 U.S.C. § 78a-78*ll* (1994).
41. *See* Plaintiff's Memorandum in Vision at 9-16, 1994 WL 326868 (No. 94-0615).
42. *Id.* at 1. Section 5(a) of the Securities Act provides:

> Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly
>
> (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or
>
> (2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

15 U.S.C. § 77e(a).

Section 5(c) of the Securities Act provides, in pertinent part:

> It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security . . . .

15 U.S.C. § 77e(c).

43. Plaintiff's Memorandum in Vision at 1, 1994 WL 326868 (No. 94-0615). Section 15(a) of the Exchange Act provides, in pertinent part:

> It shall be unlawful for any broker or dealer . . . to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security . . . unless such broker or dealer is registered in accordance with [the Exchange Act].

15 U.S.C. § 78o(a)(1).

44. Plaintiff's Memorandum in Vision at 1-2, 1994 WL 326868 (No. 94-0615). Section 17(a) of the Securities Act provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

the Exchange Act,[45] and Rule 10b-5 promulgated under the Exchange Act.[46] The SEC sought emergency relief, including a freeze on the defendants' assets, a temporary restraining order, an order for a preliminary injunction, an order for a permanent injunction, and civil penalties.[47]

The SEC described the defendants' sales activities as a "boiler room operation"[48] where sales people made cold calls and used high pressure sales techniques[49] to solicit scores of financially unsophisticated, geographically dispersed investors.[50] The solicited investors allegedly possessed little or no business experience and included clerical workers, blue-collar workers, and retirees, who were often induced to invest their retirement funds.[51] The SEC charged that the defendants made numerous false statements, including misrepresentations about immediate, exorbitant returns and the risks associated with the investment.[52] In response, the defendants argued that ownership interests

---

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q(a).

45. Plaintiff's Memorandum in Vision at 1-2, 1994 WL 326868 (No. 94-0615). Section 10(b) of the Exchange Act provides, in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b).

46. Plaintiff's Memorandum in Vision at 1-2, 1994 WL 326868 (No. 94-0615). Rule 10b-5 promulgated under the Exchange Act provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) to employ any device, scheme or artifice to defraud,
>
> (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1995).

47. Plaintiff's Memorandum in Vision at 1, 1994 WL 326868 (No. 94-0615).

48. *Id.* at 1, 5. The term "boiler room" is usually used to refer to

> a temporary operation established to sell a specific speculative security. Solicitation is by telephone to new customers, the salesman conveying favorable earnings projections, predictions of price rises and other optimistic prospects without a factual basis. The prospective buyer is not informed of known or readily ascertainable adverse information; he is not cautioned about the risks inherent in purchasing a speculative security; and he is left with a deliberately created expectation of gain without risk.

Hanly v. SEC, 415 F.2d 589, 596 n.14 (2d Cir. 1969) (citations omitted).

49. Plaintiff's Memorandum in Vision at 5, 1994 WL 326868 (No. 94-0615) (alleging the use of high pressure techniques, including "repeated telephone calls," that were "insistent and aggressive").

50. *Id.* at 2, 5, 7, 13. The defendants' allegedly raised at least $1.25 million from about 125 investors nationwide. *Id.* at 2.

51. *Id.* at 2, 7; Plaintiff's Reply Memorandum in Vision at 2-4, 1994 WL 326868 (No. 94-0615). According to the SEC, $759,000 in individual retirement account ("IRA") funds were transferred to the defendants to be invested in the LLC. Plaintiff's Memorandum in Vision at 7, 1994 WL 326868 (No. 94-0615).

52. Plaintiff's Memorandum in Vision at 5-7, 14-15, 1994 WL 326868 (No. 94-0615). The

in LLCs were not securities and therefore not subject to the federal securities laws or SEC jurisdiction.[53] The defendants also denied any misconduct.[54] They claimed that the investors were fully and accurately apprised of the risks associated with the venture in the promotional literature and operating documents.[55] The defendants pointed to carefully crafted operating provisions and procedures intended to insure that the LLC interests would not be deemed securities.[56]

On March 24, 1994, the day the SEC filed its complaint, the United States District Court granted the SEC's request for emergency relief.[57] The court froze all investor funds under the defendants' control and ordered that any new funds raised be placed in an interest-bearing escrow account.[58] After taking the matter under advisement, on April 13, 1994, less than a month after the SEC filed its complaint, the court ordered the defendants to immediately cease offering or selling interests in the LLC pending trial.[59]

On May 11, 1994, the United States District Court entered a final judgment permanently enjoining the defendants from future violations of the registration and antifraud provisions of the federal securities laws.[60] The court, however, made no findings of fact or conclusions of law.[61] The defendants agreed to the entry of a permanent injunction without admitting or denying the allegations.[62] The defendants also waived the entry of findings of facts and conclusions of law.[63] Although the SEC won its first battle and obtained a judgment, the federal court did not issue an opinion on the securities law issues. Nevertheless, the decision is significant because the granting of the injunction indicates that the LLC interests were securities.

SEC charged, among other things, that the defendants falsely stated that the LLC had an operational 20 channel wireless cable system, the LLC had obtained all necessary regulatory approvals, investors would receive 300% to 400% returns on their investment within three years, and the risks of an investment in the LLC were extremely low. *Id.* at 5-7.

53. Defendants' Memorandum in Vision at 1-2, 24, 1994 WL 326868 (No. 94-0615).

54. *See id.* at 2-3.

55. *Id.* at 3, 25-27.

56. *See id.* at 16-19.

57. SEC v. Vision Communications, Inc., Litigation Release No. 14026, 56 SEC Docket 880, 1994 WL 96945 (SEC) (Mar. 24, 1994); *Civil Action Against Vision Communications, Inc., supra* note 8; *SEC Enforcement: Alleged Boiler Room Sales of Interest in Cable Venture Subject to SEC Suit, supra* note 8.

58. *See supra* note 57.

59. SEC v. Vision Communications, Inc., Litigation Release No. 14054, 56 SEC Docket 1472, 1994 WL 148556 (SEC) (Apr. 18, 1994); *Civil Action Against Vision Communications Inc.*, SEC News Digest 94-72-3, 1994 WL 131465 (Apr. 18, 1994).

60. SEC v. Vision Communications, Inc., No. 94-0615 (CRR), 1994 WL 326868, at *1-*2 (D.D.C. May 11, 1994); SEC v. Vision Communications, Inc., Litigation Release No. 14081, 1994 WL 183414 (SEC), at *1 (May 11, 1994).

61. *See Vision Communications*, 1994 WL 326868, at *1 (final judgment); *see also Vision Communications*, 1994 WL 183414 (SEC), at *1 (litigation release).

62. *See Vision Communications*, 1994 WL 326868, at *1 (final judgment); *see also Vision Communications*, 1994 WL 183414 (SEC), at *1 (litigation release).

63. The defendants waived the entry of findings of fact and conclusions of law under Rule 52 of the Federal Rules of Civil Procedure. *See Vision Communications*, 1994 WL 326868, at *1 (final judgment).

2. *Parkersburg, Knoxville,* and Other SEC Actions

The SEC has taken action against a number of other wireless cable television and communications ventures purportedly selling LLC interests. In *SEC v. Parkersburg Wireless Limited Liability Co.*, the defendants allegedly sold LLC interests to raise capital to acquire or develop a wireless cable television system in Parkersburg, West Virginia.[64] In *SEC v. Knoxville, LLC*, the defendants allegedly sold LLC membership interests to acquire part of a wireless cable television system in Knoxville, Tennessee.[65]

Parkersburg and *Knoxville* are mirror images of the *Vision Communications* case. As in *Vision Communications*, the SEC sought temporary restraining orders, preliminary injunctions, and other relief for violation of the federal securities laws.[66] The SEC charged that the defendants violated the antifraud, securities registration, and broker-dealer registration provisions of the federal securities laws.[67] In each case, the United States District Court quickly issued temporary restraining orders.[68] The court later entered preliminary injunctions temporarily restraining and enjoining the defendants from violating the federal securities laws, pending resolution of the action on the merits.[69] In each case, the court entered final judgments permanently enjoining certain defendants from future violations of the securities laws.[70] However, because the defendants had agreed to the injunctions and waived the entry of findings of facts and conclusions of law, the federal court did not issue any opinion on the securities law issues.[71]

---

64. Complaint, SEC v. Parkersburg Wireless Ltd. Liab. Co., (No. 94-1079) (SSH) (D.D.C. May 16, 1994) [hereinafter Parkersburg Complaint]; SEC v. Parkersburg Wireless Ltd. Liab. Co., Litigation Release No. 14085, 1994 WL 186833 (SEC) (May 16, 1994); *SEC Suit Alleges Boiler Room Scheme Involving Unregistered LLC Securities*, Sec. Reg. & L. Rep. (BNA) No. 26, at 775 (May 27, 1994); *SEC Enforcement: SEC Suit Alleges Boiler Room Scheme Involving Unregistered LLC Securities*, Sec. L. Daily (BNA) (May 24, 1994).

65. Complaint, SEC v. Knoxville, LLC, (No. 941073B) (RBB) (S.D. Cal. July 11, 1994) [hereinafter Knoxville Complaint]; *Commission Obtains TRO Against Knoxville, LLC, et al.*, SEC News Digest 94-130, 1994 WL 328317 (SEC) (July 12, 1994).

66. Parkersburg Complaint, (No. 94-1079); Knoxville Complaint, (No. 941073B).

67. Parkersburg Complaint, (No. 94-1079); Knoxville Complaint, (No. 941073B).

68. Temporary Restraining Order and Order Freezing Certain Assets and Granting Other Relief, and Setting Hearing for Motion for Preliminary Injunction, SEC v. Knoxville, LLC, (No. 941073B) (RBB) (S.D. Cal. July 11, 1994); SEC v. Parkersburg Wireless Ltd. Liab. Co., Litigation Release No. 14091, 1994 WL 194875 (SEC) (May 19, 1994); Temporary Restraining Order and Order Freezing Certain Assets and Granting Other Relief, SEC v. Parkersburg Wireless Ltd. Liab. Co., (No. 94-1079) (SSH) (D.D.C. May 18, 1994); *Commission Obtains TRO Against Knoxville, LLC, et al., supra* note 65; *SEC Suit Alleges Boiler Room Scheme Involving Unregistered LLC Securities, supra* note 64; *SEC Enforcement: SEC Suit Alleges Boiler Room Scheme Involving Unregistered LLC Securities, supra* note 64; *Temporary Restraining Order Entered Against Parkersburg Wireless LLC and Other Defendants*, SEC News Digest 94-95-3, 1994 WL 195526 (May 20, 1994).

69. SEC v. Knoxville, LLC, Litigation Release No. 14538, 1995 SEC LEXIS 1594 (June 21, 1995); SEC v. Parkersburg Wireless Ltd. Liab. Co., Litigation Release No. 14126, 56 SEC Docket 2534, 1994 WL 264301 (June 15, 1994); *Court Enters Preliminary Bar in Alleged LLC Boiler Room Scheme*, Sec. Reg. & L. Rep. (BNA) No. 26, at 982 (July 8, 1994); *Preliminary Injunction Entered Against Parkersburg Wireless LLC and Other Defendants*, SEC News Dig. 94-113, 1994 WL 262956 (SEC) (June 16, 1994).

70. SEC v. Parkersburg Wireless Ltd. Liab. Co., No. 94-1079 (JHP), 1994 U.S. Dist. LEXIS 15006, at *1-*6 (D.D.C. Oct. 19, 1994); SEC v. Knoxville, LLC, Litigation Release No. 14538, 1995 SEC LEXIS 1594 (June 21, 1995).

71. SEC v. Parkersburg Wireless Ltd. Liab. Co., No. 94-1079 (JHP), 1994 U.S. Dist. LEXIS

The SEC's allegations in *Parkersburg* and *Knoxville* parallel those in *Vision Communications*. The SEC maintained that the LLC interests constituted investment contracts and were, therefore, securities.[72] The SEC charged that the defendants in both cases used high pressure sales tactics to solicit numerous financially unsophisticated investors nationwide, who were induced to invest their retirement funds through the use of false and misleading statements.[73]

By the summer of 1995, the SEC had filed complaints against defendants in at least four other unrelated actions also alleging federal securities law violations for selling interests in LLCs.[74] One of the most publicized cases is an action against Irwin "Sonny" Bloch, a "self-styled consumer advocate" and nationally syndicated radio talk show host. Bloch has been charged in the United States District Court for the Southern District of New York with defrauding investors of $3.8 million in connection with the sale of LLC membership interests in radio stations.[75] Additional SEC enforcement actions against entities and individuals offering and selling LLC interests are bound to follow.[76]

B. *State Actions*

State securities commission actions against LLCs predate the SEC's first suit in *Vision Communications*.[77] Although federal cases tend to be more

---

15006, at *1 (D.D.C. Oct. 19, 1994); SEC v. Knoxville, LLC, Litigation Release No. 14538, 1995 SEC LEXIS 1594 (June 21, 1995).

72. *See* Knoxville Complaint at 1, (No. 941073B); Memorandum of Points and Authorities in Support of Plaintiff Securities and Exchange Commission's *Ex Parte* Application for Temporary Restraining Order and Other Relief and Application for Preliminary Injunction and Other Relief at 10-19, SEC v. Knoxville, LLC, (No. 941073B) (RBB) (S.D. Cal. July 11, 1994) [hereinafter Plaintiff's Memorandum in Knoxville]; Parkersburg Complaint at 2-3, (No. 94-1079); Plaintiff's Memorandum in Parkersburg at 11-16, (No. 94-1079).

73. Knoxville Complaint at 1, 7-8, (No. 941073B); Plaintiff's Memorandum in Knoxville at 1-2, 4-7, (No. 941073B). The SEC alleges that the defendants raised $12 million from more than 575 investors in 48 states. *Id.* at 2-3. More than $2 million in individual retirement account funds ("IRAs") were invested in the LLC. *Id.* at 3; Parkersburg Complaint at 2, 9-10, (No. 94-1079); Plaintiff's Memorandum in Parkersburg at 2, 4-7, (No. 94-1079). The SEC alleges that the defendants in Parkersburg raised at least $10 million from hundreds of investors. *Id.* at 2. At least 333 investors invested $3.6 million in Parkersburg through IRAs. *Id.*

74. SEC v. Irwin Harry Bloch, Litigation Release No. 14511, 59 SEC Docket 931, 1995 WL 317420 (SEC) (May 25, 1995); SEC v. United Communications, Ltd., Litigation Release No. 14477, 59 SEC Docket 424, 1995 WL 254714 (SEC) (Apr. 24, 1995); SEC v. American Interactive Group, LLC, Litigation Release No. 14462, 59 SEC Docket 203, 1995 WL 229088 (SEC) (Apr. 10, 1995); SEC v. Future Vision Direct Mktg., Inc., Litigation Release No. 14384, 58 SEC Docket 1716, 1995 WL 25731 (SEC) (Jan. 18, 1995).

75. SEC v. Irwin Harry Bloch, Litigation Release No. 14511, 59 SEC Docket 931, 1995 WL 317420 (SEC) (May 25, 1995).

76. *See supra* note 11 and accompanying text.

77. For example, the Indiana Cease and Desist Order in *In re Express Communications* states that North Dakota and South Dakota issued cease and desist orders against Express Communications on April 14, 1992, and February 27, 1992, respectively, two years before the SEC began to take action against such wireless communication companies. *Compare In re* Express Communictions, Inc., No. 93-0027 CD, 1993 Ind. Sec. LEXIS 46, at *8 (Mar. 23, 1993) (orders issued in 1992) *with* SEC v. Vision Communications, Inc., Litigation Release No. 14026, 56 SEC Docket 880, 1994 WL 96945 (SEC) (Mar. 24, 1994) (first SEC action filed March 24, 1994).

widely followed and carry more precedential value than similar state cases,[78] it appears the numerous state prosecutions of LLCs prompted the SEC to initiate actions against LLCs under the federal securities laws.[79] In fact, the SEC briefs in *Vision Communications*, *Parkersburg*, and *Knoxville* each catalog state actions against LLC offerings in support of the SEC's claims.[80]

Table I summarizes some of the actions taken under state securities laws against defendants offering or selling LLC interests.[81] Table I is organized by state and indicates the action taken, the securities law violations raised, and the theories of liability discussed.[82] Action has been taken against LLCs under state securities laws in Colorado, Georgia, Illinois, Indiana, Kansas, Minnesota, Missouri, North Dakota, Pennsylvania, South Dakota, Washington, and Wisconsin.[83] Many other states have also taken action, but such lower court and administrative securities decisions often are not reported.[84] As a result, the list in Table I may be only a small sampling of the state actions against defendants offering or selling LLC interests.

The vast majority of these state actions involve defendants offering LLC interests in wireless communication companies, such as cellular telephone businesses, interactive video ventures, and wireless cable television systems.[85] State regulators charge that many of these wireless communication companies are packaging their investment products as LLCs to avoid state and federal securities laws.[86] State actions against these LLCs have been aimed at closing down such wireless communication investment-sales operations.[87]

---

78. Most state securities statutes parallel, or are patterned after, the federal Securities Act and the federal Exchange Act. Sauer v. Hays, 539 P.2d 1343, 1346 (Colo. Ct. App. 1975); *see also* People v. Schock, 199 Cal. Rptr. 327, 331 (Cal. Ct. App. 1984) (stating California law was patterned after the federal Securities Act). While state courts are not bound by federal law interpreting their state's securities statutes, state courts generally consider federal authority highly persuasive. *See, e.g.*, State v. Gunnison, 618 P.2d 604, 606-07 (Ariz. 1980); *Schock*, 199 Cal. Rptr. at 331; Lowery v. Ford Hill Inv. Co., 556 P.2d 1201, 1204 (Colo. 1976); *Sauer*, 539 P.2d at 1346-47; State v. Kershner, 801 P.2d 68, 69 (Kan. Ct. App. 1990).

79. A list of state actions is set forth in Table I, pp. 495-98 of this article. Four states brought action against Parkersburg Wireless Limited Liability Company before the SEC brought its action in the summer of 1994. *See* Plaintiff's Memorandum in Parkersburg at 9-10, (No. 94-1079). Two states brought action against the two named individual defendants in *Vision Communications* before the SEC brought its action against them in *Vision Communications*. *See* Plaintiff's Memorandum in Vision at 2-3, 1994 WL 326868 (No. 94-0615). At least three states, South Dakota, South Carolina, and Iowa, issued cease and desist orders against Knoxville, LLC before the SEC brought its action. Plaintiff's Memorandum in Knoxville at 7, (No. 941073B).

80. *See* Plaintiff's Memorandum in Parkersburg at 9-10, (No. 94-1079); Plaintiff's Memorandum in Vision at 2-3, 1994 WL 326868 (No. 94-0615); Plaintiff's Memorandum in Knoxville at 7, (No. 941073B).

81. *See infra* Table I pp. 495-98.

82. *Id.*

83. *Id.*

84. *See* JOSEPH C. LONG, 12 BLUE SKY LAW xi (1992). For example, a *Wall Street Journal* article reported that 16 states had filed actions against Express Communications, a company involved in offering LLC interests in wireless communications companies. Emshwiller, *supra* note 5, at B2. However, WESTLAW and LEXIS reported only three such actions against Express Communications. *See infra* Table I pp. 495-98, Illinois Express Action, Indiana Express Action, and Washington Express Action.

85. *See infra* Table I pp. 495-98.

86. Emshwiller, *supra* note 5; Emshwiller, *supra* note 11.

87. Emshwiller, *supra* note 5; Emshwiller, *supra* note 11.

In each of the cases listed in Table I, the state charged the defendants offering LLC interests with violating securities registration and broker-dealer registration provisions of state securities laws.[88] In some cases, the state charged the defendants with violating antifraud provisions as well.[89] In every case, the trier of fact found sufficient evidence to conclude that the defendants violated state securities laws in offering or selling LLC interests.[90] The defendants did not prevail in any of the actions reported.[91] Unfortunately, the majority of these cases involved the issuance of summary cease and desist orders.[92] Often the trier of fact either cited no legal theory, or simply made a conclusory finding that the LLC interest was an investment contract and therefore constituted a security.[93]

III. THEORIES OF LIABILITY AND POSSIBLE DEFENSES

The securities laws apply only if a transaction involves a security.[94] While there are some differences, the basic definition of a "security" in the Securities Act,[95] the Exchange Act[96] and under state securities laws[97] is the same.[98] The term "security" generally covers a broad range of transactions, but there is no single test for determining what constitutes a security.[99] Each

88. *See infra* Table I pp. 495-98 (see column labeled "Securities Law Violations Addressed").

89. *Id.*

90. *See infra* Table I pp. 495-98 (see column labeled "Action Taken").

91. *Id.*

92. *Id.*

93. *See infra* Table I pp. 495-98 (see column labled "Legal Theories Discussed"); *see also In re* UEG, L.C., No. 93E068, 1993 WL 208898 (Kan. Sec. Comm'r) (May 12, 1993) (no legal theory discussed); *In re* Hancock Communications Riverside PCS, No. 93E-058, 1993 WL 145928 (Kan. Sec. Comm'r) (Apr. 14, 1993) (conclusory finding that LLC interest was an investment contract).

94. HAROLD S. BLOOMENTHAL, 3 SECURITIES AND FEDERAL CORPORATE LAW § 2.02 (1990).

95. Securities Act of 1933 § 2(1), 15 U.S.C. § 77b(1) (1994).

96. Securities Exchange Act of 1934 § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1994).

97. Thirty-five states have adopted securities acts based on the 1956 version of the Uniform Securities Act, which was amended in 1958. UNIF. SEC. ACT (1958), 7B U.L.A. 154 (Supp. 1995). Six states have adopted securities acts based on the 1985 revision of the Uniform Securities Act, which was amended in 1988. UNIF. SEC. ACT (1988), 7B U.L.A. 87 (Supp. 1995). Therefore, forty-one jurisdictions have adopted acts modeled on the Uniform Securities Act. The 1956 Uniform Securities Act and the 1985 Uniform Securities Act shall be referred to collectively herein as the Uniform Securities Acts. The term "security" is defined in § 401(l) of the 1956 Uniform Securities Act and in § 101(16) of the 1985 Uniform Securities Act. UNIF. SEC. ACT § 401(l) (1958), 7B U.L.A. 580-81 (1985); UNIF. SEC. ACT § 101(16) (1988), 7B U.L.A. 94 (Supp. 1995).

98. *Compare* 15 U.S.C. § 77b(1); 15 U.S.C. § 78c(a)(10); UNIF. SEC. ACT § 101(16), 7B U.L.A. 94 (Supp. 1995); UNIF. SEC. ACT § 401(l), 7B U.L.A. 580-81 (1985). The definition of "security" in the Uniform Securities Act is modeled after the definition in § 2(1) of the federal Securities Act. UNIF. SEC. ACT § 401(l), 7B U.L.A. 583 cmt. (1985). The definition of "security" in § 3(a)(10) of the Exchange Act is virtually identical to the definition in § 2(1) of the Securities Act. *See infra* note 99. Further, the United States Supreme Court stated that the definition of "security" will be treated as identical for purposes of both the Securities Act and the Exchange Act. Landreth Timber Co. v. Landreth, 471 U.S. 681, 686 n.1 (1985); United Hous. Found., Inc. v. Forman, 421 U.S. 837, 847 n.12 (1975); Tcherepnin v. Knight, 389 U.S. 332, 335-36, 342 (1967).

99. LOUIS LOSS & JOEL SELIGMAN, 2 SECURITIES REGULATION 871 (3d ed. 1989 & 1994 Supp.); *see also* statutory definitions of "security," *supra* note 98. For example, § 2(1) of the Securities Act, which is virtually identical to the definition in § 3(a)(10) of the Exchange Act and

of the acts sets forth a list of specific instruments that are considered securities, such as stocks, bonds, notes, and debentures.[100] The statutory definitions also include a number of catch-all phrases for instruments that do not fit into the conventional categories, such as "certificate of interest or participation in any profit-sharing agreement," "investment contract," and any "instrument commonly known as a 'security.'"[101]

Although a few states have amended their state law definition of a "security" to include interests in limited liability companies,[102] the federal acts and the securities laws in most states do not expressly list interests in limited liability companies.[103] Since LLC interests generally are not included in the enumerated list of interests and instruments that constitute securities under the federal securities acts or the Uniform Securities Acts,[104] LLC promoters and commentators argue that LLC interests are not securities.[105]

The SEC, state regulators, and commentators counter that LLC promoters may not use formalistic devices to insulate what is in substance a security from the application of the securities laws.[106] They argue that the United

---

the definitions in the Uniform Securities Acts, provides:

> The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. §77b(1).

Section 3(a)(10) of the Exchange Act defines a security in substantially the same manner except (i) it does not contain a reference to "evidence of indebtedness," (ii) it excludes from the definition short-term "commercial paper," and (iii) it uses a slightly different approach to classify oil and gas interests. 15 U.S.C. § 78c(a)(10).

100. *See supra* note 99, definition of security in § 2(1) of the Securities Act; 15 U.S.C. § 78c(a)(10); UNIF. SEC. ACT. § 401(l) (1958), 7B U.L.A. 580-81 (1985); UNIF. SEC. ACT. § 101(16) (1988), 7B U.L.A. 94 (Supp. 1995).

101. *See supra* note 100. These general catch-all phrases are not defined in the federal securities acts or the Uniform Securities Acts. As a result, the courts have been left to define these terms.

102. The legislatures in Alaska, California, Indiana, New Mexico, Ohio, Pennsylvania, Vermont, and Wisconsin amended the definition of security in their state securities laws to expressly include certain LLC interests. *See supra* note 14. The statutory language of these provisions is set forth *infra* Table II pp. 499-501. Commentators argue that the enumeration of certain LLC interests in the list of instruments constituting securities does not result in LLC interests becoming securities *per se*. For a discussion of this issue and the various defenses see *infra* parts III.E.2, III.E.3.

103. *See* statutory definitions of "security," *supra* notes 97-99.

104. *See* statutory definitions of "security," *supra* notes 97-99.

105. *See, e.g.*, Opposition to Plaintiff SEC's Application for Temporary Restraining Order and Other Relief and Memorandum of Points and Authorities at 11-12, SEC v. Parkersburg Wireless Ltd. Liab. Co., (No. 94-1079) (SSH) (D.D.C. filed May 16, 1994) [hereinafter Defendants' Memorandum in Parkersburg].

106. *See, e.g.*, Plaintiff's Memorandum in Vision at 10, 1994 WL 326868 (No. 94-0615) (citing Williamson v. Tucker, 645 F.2d 404, 422 (5th Cir.), *cert. denied*, 454 U.S. 897 (1981)); Plaintiff's Memorandum in Parkersburg at 12, (No. 94-1079) (citing *Williamson*, 645 F.2d at 422);

States Supreme Court has rejected the use of rigid, formalistic analysis to determine whether an instrument constitutes a security.[107] Courts have broadly construed the securities acts to extend to "[n]ovel, uncommon or irregular devices"[108] in an attempt to reach the "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits."[109]

The SEC, state regulators, and commentators assert that LLC interests are securities because they fall into the general catch-all categories that have been left to the courts to define.[110] They argue that LLC interests are securities because they (i) constitute an investment contract;[111] (ii) meet the requirements of the risk capital test adopted by some states;[112] (iii) possess the characteristics of stock;[113] (iv) constitute an instrument commonly known as a security;[114] or (v) are subject to liability on state statutory grounds.[115] The following sections discuss these various theories, present possible defenses, and conclude with the author's evaluation of each theory.

A. *Investment Contract Theory*

1. Arguments Asserted

The SEC[116] and at least twenty-three state securities commissions[117] have taken the position that certain LLC interests constitute securities under the investment contract test set forth in *SEC v. W.J. Howey Co.*[118] Section 2(1) of the Securities Act,[119] section 3(a)(10) of the Exchange Act[120] and most state securities laws[121] provide that an "investment contract" is a security. In *Howey*, the United States Supreme Court set forth a four-prong test to

---

Plaintiff's Memorandum in Knoxville at 10, (No. 941073B) (citing *Williamson*, 645 F.2d at 422).

107. *See* Tcherepnin v. Knight, 389 U.S. 332, 338 (1967).

108. SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943).

109. SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946).

110. *See supra* note 101 and accompanying text; *infra* parts III.A-D.

111. *See infra* part III.A.

112. *See infra* part III.B.

113. *See infra* part III.C.

114. *See infra* part III.D.

115. *See infra* part III.E.

116. *See, e.g.*, Plaintiff's Memorandum in Vision at 10-13, 1994 WL 326868 (No. 94-0615); Plaintiff's Memorandum in Parkersburg at 12-16, (No. 94-1079); Plaintiff's Memorandum in Knoxville at 10-14, (No. 941073B).

117. *See* 1 Blue Sky L. Rep. (CCH) ¶ 6551; *see also infra* Table I pp. 495-98 (see columns labeled "Legal Theories Discussed" and "Action Taken" for associated citations); *infra* Table III pp. 502-05 (discussion of Connecticut release, Indiana policy statement, Kansas interpretive opinion, Minnesota interpretive opinion, Montana opinion letter, Oklahoma exemption request, South Carolina statement of policy, South Dakota Division of Securities letter, Tennessee statement of policy, and Wyoming interpretative opinion).

118. 328 U.S. at 298-99.

119. 15 U.S.C. § 77b(1). For the text of § 2(1), see *supra* note 99.

120. 15 U.S.C. § 78c(a)(10). For a comparison of the text of § 2(1) of the Securities Act and § 3(a)(10) of the Exchange Act, see *supra* note 99.

121. UNIF. SEC. ACT § 401(l) (1958), 7B U.L.A. 580-81 (1985); UNIF. SEC. ACT § 101(16) (1988), 7B U.L.A. 94 (Supp. 1995). For a discussion of the state law definitions of a "security," see *supra* notes 97-99.

determine whether an interest is an "investment contract."[122] The Court stated, "an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person [1] invests his money, [2] in a common enterprise and [3] is led to expect profits [4] solely from the efforts of a promoter or a third party . . . ."[123]

The following is a discussion of each of the four elements of the *Howey* investment contract test, which includes an overview of how courts have interpreted each element and an analysis of whether an LLC interest is likely to meet each requirement. The analysis indicates that LLC interests typically meet the first three prongs of the *Howey* test; therefore, the key issue in determining whether an LLC interest is a security usually depends on whether profits are expected from the efforts of a promoter or a third party. Consequently, most of the discussion in this section focuses on the fourth prong of the *Howey* test, with particular emphasis on the arguments asserted by the SEC and state securities regulators, who have claimed that certain LLC interests are securities.

a. *Investment of Money*

Courts have broadly interpreted the investment of money requirement.[124] It is clear that the investor need not invest cash.[125] All that is required is that the purchaser give up some tangible and definable consideration.[126] Such consideration may be goods or services.[127] In fact, anything constituting legal consideration under contract law is probably sufficient to meet the investment of money requirement.[128]

An investment in an LLC normally would satisfy the first prong of the *Howey* investment contract test. While the LLC statutes do not require minimum contributions in exchange for membership interests,[129] members usually agree as to what and how much property or services each member will con-

122. *See W.J. Howey Co.*, 328 U.S. at 298-99.

123. *Id.* The definition of "security" in § 3(a)(10) of the Exchange Act is virtually identical to the definition in § 2(1) of the Securities Act. *See supra* note 99. The United States Supreme Court has stated that the definition of "security" will be treated as identical for purposes of both the Securities Act and the Exchange Act. *Supra* note 98. As a result, even though the *Howey* Court expressly addressed the definition of "investment contract" under the Securities Act, the same four-prong test is used to interpret "investment contract" in the Exchange Act and in many state securities laws. *See supra* notes 78, 98.

124. *See infra* note 127.

125. In International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979), the United States Supreme Court expressly rejected the argument that to meet the definition of an "investment contract" the investment must take the form of cash. *Id.* at 560 n.12.

126. *Id.* at 560.

127. *See, e.g.*, Hector v. Wiens, 533 F.2d 429, 432 (9th Cir. 1976) (providing credit for a loan); El Khadem v. Equity Sec. Corp., 494 F.2d 1224, 1228 (9th Cir.) (supplying collateral for a loan), *cert. denied*, 419 U.S. 900 (1974); Harris v. Republic Airlines, Inc., Fed. Sec. L. Rep. (CCH) ¶ 93,772 (D.D.C. May 19, 1988) (specific wage concessions); Sandusky Land, Ltd. v. Uniplan Groups, Inc., 400 F. Supp. 440, 445 (N.D. Ohio 1975) (services).

128. Carl W. Schneider, *The Elusive Definition of a "Security," in* GLOBAL CAPITAL MARKETS AND THE DISTRIBUTION OF SECURITIES 105, 109 (Franklin E. Gill ed., 1991). *But see* American Grain Ass'n v. Canfield, Burch & Mancuso, 530 F. Supp. 1339 (W.D. La. 1982).

129. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 5.03, at 5-4.

tribute to the enterprise.[130] Most LLC statutes are broadly phrased so that cash, property, or services constitute eligible contributions.[131] Member contributions are often important in determining each member's rights.[132] In the SEC actions and the state actions noted in Table I, investors contributed cash to the LLC ventures at issue.[133]

b. *Common Enterprise*

Generally all courts agree that the common enterprise prong of the *Howey* test[134] is satisfied when there is a pooling of interests of several investors who share an investment risk with each other.[135] This type of pooling of multiple investors' interests is known as "horizontal commonality."[136] Such an arrangement will usually satisfy any version of the *Howey* test.[137]

Courts disagree, however, on whether "vertical commonality" is sufficient.[138] Vertical commonality requires only that one investor and one promoter be involved in some common enterprise.[139] Some courts require a

---

130. *Id.* at 5-4 to 5-5.

131. *Id.* § 5.04, at 5-5.

132. *Id.* § 1.04, at 1-4, § 5.02, at 5-2.

133. *See, e.g.*, Plaintiff's Memorandum in Vision at 2, 4, 1994 WL 326868 (No. 94-0615); Plaintiff's Memorandum in Parkersburg at 2, 5, 13, (No. 94-1079); Plaintiff's Memorandum in Knoxville at 3, 11, (No. 941073B); *In re* Express Communications, Inc., No. 9200106, 1993 WL 566300, at *17 (Ill. Sec. Dep't) (Dec. 13, 1993) [hereinafter Illinois Express Action]; Report and Recommendation of Referee at 51, Cleland v. Express Communications, Inc., No. 50-93-0075 (Ga. Mar. 23, 1994) [hereinafter Georgia Express Action].

134. For in-depth discussions of the common enterprise test and related case law, see 2 LOSS & SELIGMAN, *supra* note 99, at 927-35; Carl W. Schneider, *The Elusive Definition of a "Security": A 1990 Update, in* GLOBAL CAPITAL MARKETS AND THE DISTRIBUTION OF SECURITIES 119, 120-21 (Franklin E. Gill ed., 1991); Steinberg Article, *supra* note 7, at 1108-09 & nn.21-23, 26; John F. Wagner, Jr., Annotation, *"Common Enterprise" Element of Howey Test to Determine Existence of Investment Contract Regulable as "Security" Within Meaning of Federal Securities Act of 1933 (15 USCS §§ 77a et seq.) and Securities Exchange Act of 1934 (15 USCS §§ 78a et seq.)*, 90 A.L.R. FED 825 (1988).

135. MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW § 2.02, at 22 (1989); Schneider, *supra* note 134, at 120; Steinberg Article, *supra* note 7, at 1108 n.22 (quoting STEINBERG, *supra*, at 250).

136. *See supra* note 135. The Third, Sixth, and Seventh Circuits hold that a showing of horizontal commonality is required to meet the common enterprise test. *See, e.g.*, Hart v. Pulte Homes of Mich. Corp., 735 F.2d 1001, 1004 (6th Cir. 1984) (citing Union Planters Nat'l Bank v. Commercial Credit Business Loans, Inc., 651 F.2d 1174, 1183 (6th Cir.), *cert. denied*, 454 U.S. 1124 (1981)); Salcer v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 682 F.2d 459, 460 (3d Cir. 1982); Milnarik v. M-S Commodities, Inc., 457 F.2d 274, 276-77 (7th Cir.), *cert. denied*, 409 U.S. 887 (1972).

137. *See supra* note 135.

138. *See* Long v. Schultz Cattle Co., Inc., 881 F.2d 129, 140 & n.11 (5th Cir. 1989); 2 LOSS & SELIGMAN, *supra* note 99, at 928-35 & n.130; STEINBERG, *supra* note 135, § 2.02, at 22; Steinberg Article, *supra* note 7, at 1108-09. The Fifth, Ninth, and Eleventh Circuits have expressly rejected the view that horizontal commonality is required to meet the common enterprise test. *Long*, 881 F.2d at 140. These circuits have found vertical commonality sufficient. *See, e.g.*, Villeneuve v. Advanced Business Concepts Corp., 698 F.2d 1121, 1124 (11th Cir. 1983), *aff'd en banc*, 730 F.2d 1403 (11th Cir. 1984); SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 478-79 (5th Cir. 1974); SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 482 n.7 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973). Some state statutes expressly state that vertical commonality is sufficient to meet the common enterprise requirement. *See, e.g.*, COLO. REV. STAT. ANN. § 11-51-201(17) (West 1995).

139. STEINBERG, *supra* note 135, § 2.02, at 22; Schneider, *supra* note 134, at 121; Steinberg

showing of horizontal commonality, rather than vertical commonality alone, to satisfy the common enterprise test.[140]

An investment in an LLC would normally meet the common enterprise requirement. Most LLC statutes require an LLC to have more than one owner or two or more members.[141] In the typical LLC venture, multiple investors pool their contributions and share the risk of the venture. Under such circumstances there is horizontal commonality and the common enterprise element of the *Howey* test is met.

Probably the only instance in which an LLC would not meet the horizontal commonality test is when it had only one owner or member. LLC statutes in at least seven states permit an LLC to be formed with only one owner and do not require the LLC to have more than one member.[142] Even though a number of statutes permit this structure, the typical LLC will usually have more than one member. Also, if there is at least one investor and one promoter, the venture may still meet the vertical commonality test which is sufficient to meet the common enterprise requirement in many circuits.[143] In the SEC actions, for example, prosecutors alleged both horizontal commonality and vertical commonality were present because each investor received a pro rata share of the profits generated through operation or sale of the LLC venture and, therefore, the common enterprise element was satisfied.[144]

c. *Expectation of Profits*

In *United Housing Foundation, Inc. v. Forman*,[145] the United States Supreme Court elaborated on the expectation of profits element of the *Howey* test.[146] The Court noted that in referring to profits it has meant either capital appreciation from the development of the initial investment,[147] or a participa-

---

Article, *supra* note 7, at 1109.

140. *Long*, 881 F.2d at 140-41; STEINBERG, *supra* note 135, § 2.02, at 22; Steinberg Article, *supra* note 7, 1108-09 & n.23. The theoretical and practical problems presented by requiring only horizontal commonality are discussed in 2 LOSS & SELIGMAN, *supra* note 99, at 930-31; James D. Gordon III, *Common Enterprise and Multiple Investors: A Contractual Theory for Defining Investment Contracts and Notes*, 1988 COLUM. BUS. L. REV. 635, 660-63.

141. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 4.03, at 4-3 to 4-4.

142. *Id.* at 4-3 n.8. At least one commentator, Allan Donn, warns that a single member LLC is not advisable, even if state LLC statutes permit such a structure. Mr. Donn notes that the Internal Revenue Service ("IRS") has not announced how a single member LLC will be taxed, therefore, there is a substantial risk that the IRS will classify such an LLC as a corporation for tax purposes. Donn, *supra* note 1, § 4.3, at PGLLC-17 to -18.

143. *See supra* notes 138-40 and accompanying text. The broader version of the vertical commonality approach only requires some relationship between the investor's success or failure and the promoter's efforts. Under a narrower version of the vertical commonality test, there must be a direct relationship between the investor's profit and loss and the promoter's profit and loss. *See id.*

144. *See, e.g.*, Plaintiff's Memorandum in Vision at 11-12, 1994 WL 326868 (No. 940615); Plaintiff's Memorandum in Parkersburg at 13-14, (No. 94-1079); Plaintiff's Memorandum in Knoxville at 11-12, (No. 941073B); *see also* Illinois Express Action at *16, 1993 WL 566300 (No. 9200106).

145. 421 U.S. 837 (1975).

146. *Forman*, 421 U.S. at 852-58.

147. *Id.* at 852. To illustrate the capital appreciation concept, the Court cited SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943), which involved the "sale of oil leases conditioned on [the] promoters' agreement to drill [an] exploratory well." *Forman*, 421 U.S. at 852.

tion in earnings resulting from the use of investors' funds.[148] The Court stressed that the critical inquiry is the motive of the purchaser.[149] If an investor is attracted by the prospect of a return on his investment, the expectation of profits element is met.[150] However, when a purchaser is motivated to use or consume the item purchased, the expectation of profits element is not met.[151]

In most situations, an investor contributes to an LLC venture expecting to make a profit from either capital appreciation or earnings.[152] Generally, there is no problem establishing the expectation of profits element.[153] For example, in the SEC actions, prosecutors presented evidence that promoters enticed investors by promises of enormous and immediate returns in brochures and sales calls, thereby demonstrating that purchasers were motivated to invest because of the expectation of profits.[154] Even though state LLC statutes do not expressly require LLCs to be operated for profit,[155] and some states even appear to permit not-for-profit LLCs,[156] the vast majority of LLCs are operated for profit.[157]

d. *Solely from the Efforts of Others*

The final element of the *Howey* test is that the investor must expect profits to be derived "solely from the efforts of a promoter or a third party."[158] In applying the *Howey* test, lower federal courts have rejected a literal inter-

148. *Forman*, 421 U.S. at 852. To illustrate the concept of participation in earnings, the Court cited Tcherepnin v. Knight, 389 U.S. 332, 338-39 (1967), where "dividends on the investment [were] based on a savings and loan association's profits." *Forman*, 421 U.S. at 852.

149. *Forman*, 421 U.S. at 852-53.

150. *Id.* at 852 (quoting SEC v. W.J. Howey Co., 328 U.S. 293, 300 (1946)). Lower court opinions have held that "the promotion of an investment 'largely for tax advantages'" may constitute an "expectation of profits." Also, "'the prospect of tax benefits resulting from initial losses does not necessarily detract from an expectation of profits.'" 2 LOSS & SELIGMAN, *supra* note 99, at 937 & nn.150-51.

151. *Forman*, 421 U.S. at 852-53. For example, in *Forman*, the Court held that the sale of stock to tenants in a cooperative housing project did not constitute the sale of securities since such tenants purchased the stock for "personal consumption, [as] living quarters for personal use." *Id.* at 858. Similarly, the Court noted that the purchase of real estate would not constitute the purchase of a security if the purchaser desired to "'occupy the land or develop it [himself].'" *Id.* at 852-53 (quoting SEC v. W.J. Howey Co., 328 U.S. 293, 300 (1946)).

152. Steinberg Article, *supra* note 7, at 1110.

153. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-2; Peralta, *supra* note 7, at 41.

154. *See, e.g.*, Plaintiff's Memorandum in Vision at 5-6, 1994 WL 326868 (No. 94-0615); Plaintiff's Memorandum in Parkersburg at 6, (No. 94-1079); Plaintiff's Memorandum in Knoxville at 5-6, (No. 941073B).

155. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 16.07, at 16-29; Donn, *supra* note 1, § 4.5, at PGLLC-18.

156. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 16.07, at 16-29 & n.119; Donn, *supra* note 1, § 4.5, at PGLLC-18.

157. Commentator Allan Donn argues that even though some state LLC statutes do not expressly require LLCs to be operated for profit, there may be an implied "for profit" requirement if the statute sets forth the permitted businesses in which an LLC may engage. Mr. Donn cautions that even if not-for-profit LLCs are permitted by state law, an LLC that does not conduct a business and have a profit objective risks losing the tax advantages associated with an LLC. Donn, *supra* note 1, § 4.5, at PGLLC-18.

158. SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946).

pretation of the word "solely." Ten circuits have adopted a more liberal and flexible interpretation, simply requiring proof that "the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."[159] As a result, many courts have found an investment constituted a security, even when the investor was required to participate to some extent, provided his efforts were not the undeniably significant ones.[160]

While the United States Supreme Court expressly reserved judgment on whether the term "solely" should be interpreted literally,[161] the Court deleted the term "solely" in its restated formulation of the *Howey* test.[162] Also, the Court's repeated direction to evaluate transactions in light of economic realities and the ease with which the securities laws could be circumvented if the "solely" language were interpreted literally suggests that when faced with the question, the Court will adopt the more liberal and flexible interpretation.[163]

Since most LLCs involve an investment of money in a common enterprise with the expectation of profits,[164] the pivotal issue in determining whether an LLC interest is a security becomes whether profits are expected "solely from the efforts of others." If profits are to come substantially from the efforts of others, the interest may be a security. On the other hand, if profits are to come from the joint efforts of the members, the interest may not be a security.[165] So whether an LLC interest is a security depends, in part, on the management structure of the LLC, the allocation of management control, and the relationship among investors and third parties.

---

159. This more liberal and flexible test is set forth in SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 482 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973). The more liberal interpretation of the term "solely" has been adopted by nine other circuits. Rivanna Trawlers, Unlimited v. Thompson Trawlers, Inc., 840 F.2d 236, 240 n.4 (4th Cir. 1988); SEC v. Professional Assocs., 731 F.2d 349, 357 (6th Cir. 1984); Goodwin v. Elkins & Co., 730 F.2d 99, 103 (3d Cir.), *cert. denied*, 469 U.S. 831 (1984); SEC v. Aqua-Sonic Prods. Corp., 687 F.2d 577, 582 (2d Cir.), *cert. denied sub nom.* Hecht v. SEC, 459 U.S. 1086 (1982); Kim v. Cochenour, 687 F.2d 210, 213 n.7 (7th Cir. 1982); Baurer v. Planning Group, Inc., 669 F.2d 770, 778-79 (D.C. Cir. 1981); Williamson v. Tucker, 645 F.2d 404, 418 (5th Cir.), *cert. denied*, 454 U.S. 897 (1981); Aldrich v. McCulloch Properties, Inc., 627 F.2d 1036, 1040 n.3 (10th Cir. 1980); Fargo Partners v. Dain Corp., 540 F.2d 912, 914-15 (8th Cir. 1976).

160. *See, e.g.*, SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 479, 485 (5th Cir. 1974); *Glenn W. Turner Enters.*, 474 F.2d at 482.

161. United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852 n.16 (1975).

162. In *Forman*, the United States Supreme Court restated the *Howey* test as follows: "The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." *Id.* at 852. The restated test is repeated in International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 561 (1979).

163. SEC v. Aqua-Sonic Prods. Corp., 687 F.2d 577, 582 (2d Cir.), *cert. denied sub nom.* Hecht v. SEC, 459 U.S. 1086 (1982).

164. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-2; SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-10.

165. *Cf.* 2 LOSS & SELIGMAN, *supra* note 99, at 961-63 (analogous discussion distinguishing partnership interests that are securities from those that are not).

[1] Management Structure

In literature promoting the use of LLCs, commentators have touted the LLC as a highly flexible entity which allows the owners of the business to set up management of the entity as they please.[166] While most LLC statutes provide that management is vested in the members of the LLC,[167] the statutes generally allow the members to opt out of the member-managed form and adopt a corporate-style centralized management structure by agreement.[168] In other words, the LLC members can choose to manage the LLC directly themselves or delegate full or partial responsibility for management to a manager or group of managers.[169] Typically, such managers are not required to be members.[170]

In a very closely held, member-managed LLC in which each member is financially sophisticated and participates actively in the venture, the LLC interest is probably not a security under the *Howey* investment contract test.[171] But not all LLCs are closely held or member-managed. Some LLCs have hundreds of members. In some cases, members have placed controlling power in the hands of promoters or third parties.[172] The structure of such LLCs often resembles a corporation or a limited partnership where investors are passive participants. The key inquiry in such situations becomes whether "the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."[173] Given the flexibility of the LLC management structure, whether an LLC is a security under the investment contract test depends on the facts and circumstances of the particular investment arrangement.

[2] Allocation of Management Control

If, for example, an LLC's articles of organization or operating agreement allocate members' powers as in a limited partnership, the LLC interest may be a security.[174] Limited partnership interests are normally considered securities under the *Howey* investment contract test.[175] This is because limited partners

166. *See, e.g.*, SARGENT HANDBOOK, *supra* note 1, § 1.03, at 1-4.

167. Most LLC statutes provide that the entity will be managed by LLC members, unless the articles of organization provide otherwise. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 1.05, at 1-4; SARGENT HANDBOOK, *supra* note 1, at 1-13 n.38; Donn, *supra* note 1, § 10, at PGLLC-36 to -37. Minnesota, North Dakota, Oklahoma, and Texas permit management by separate managers, as in corporations. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 8.02, at 8-2, 1S-47 (Cum. Supp. 1995).

168. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 1.05, at 1-4; Keatinge et al., *supra* note 1, at 390.

169. SARGENT HANDBOOK, *supra* note 1, at 1-4; Donn, *supra* note 1, § 10, at PGLLC-37.

170. Donn, *supra* note 1, § 10, at PGLLC-37; Keatinge et al., *supra* note 1, at 397.

171. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-2.

172. *See, e.g.*, Emshwiller, *supra* note 11; Plaintiff's Memorandum in Vision at 2-4, 12-13, 1994 WL 326868 (No. 940615); Plaintiff's Memorandum in Parkersburg at 2, 14-15, (No. 94-1079).

173. *See supra* note 159 and accompanying text.

174. *Cf.* Williamson v. Tucker, 645 F.2d 404, 423 (5th Cir.) (indicating that if an agreement allocates partnership power as in a limited partnership, such an arrangement may be held to be an investment contract), *cert. denied*, 454 U.S. 897 (1981).

175. *See, e.g.*, L&B Hosp. Ventures, Inc. v. Healthcare Int'l, Inc., 894 F.2d 150, 151 (5th

have little or no authority to participate in the management of the partnership.[176] In fact, to insure their status as limited partners and to preserve their limited liability, it is essential that they not participate in the management of the partnership.[177] Also, limited partners cannot ordinarily dissolve a partnership nor do they have the power to bind other partners.[178] Limited partners, therefore, are presumed to depend on the efforts of others.[179] Consequently, if an LLC is structured as a limited partnership, it is likely that an interest in such an LLC is a security.[180]

But what about situations where the articles of organization or operating agreement allocates management powers to each member? LLC promoters argue that under such circumstances each member has the ability to protect his or her investment and exercise his or her managerial rights.[181] The mere delegation of certain powers does not undermine such rights.[182] Because the investors are ultimately in control and, therefore, not dependent on the efforts of others, there is no investment contract and no security.[183]

The SEC and state regulators argue that the grant of certain management powers in an operating document should not immunize an LLC from charges that its interests are securities. For example, the operating documents of some LLCs grant their members management powers, but those same LLCs have hundreds of geographically-dispersed, unsophisticated members who have delegated control of the entity to promoters or third parties.[184] The SEC and

---

Cir.), *cert. denied*, 498 U.S. 815 (1990); Goodman v. Epstein, 582 F.2d 388, 406-08 (7th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979); 3 BLOOMENTHAL, *supra* note 94, § 2.05[2] (citing numerous authorities).

176. Youmans v. Simon, 791 F.2d 341, 346 (5th Cir. 1986); *see, e.g.*, 3 BLOOMENTHAL, *supra* note 94, § 2.05[2], at 2-50.

177. *See, e.g.*, 3 BLOOMENTHAL, *supra* note 94, § 2.05[2].

178. *Youmans*, 791 F.2d at 346.

179. SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-10.

180. *Cf. supra* note 174. Limited partnership interests are considered securities under the investment contract test because of the limited partners' (1) lack of management control, (2) limited liability, (3) lack of dissolution powers, and (4) lack of power to bind. *See supra* notes 175-78. An LLC may be structured to resemble a limited partnership. As indicated in the text, an operating agreement can delegate substantial authority to managers, leaving LLC members with little or no control. *See supra* notes 166-69 and accompanying text; *see also* SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-11. Members of an LLC also have limited personal liability. SARGENT HANDBOOK, *supra* note 1, § 2.02[1], at 2-3; Donn, *supra* note 1, § 1, at PGLLC-6, § 6.2, at PGLLC-30. Dissolution provisions of LLC acts typically are modeled after the Revised Uniform Limited Partnership Act dissolution provisions. Donn, *supra* note 1, § 12.2, at PGLLC-45 to -46. Also, an LLC member's power to bind can be restricted by a provision in the articles of organization or elsewhere. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 8.06, at 8-17.

181. *See, e.g.*, Defendants' Memorandum in Vision at 16-19, 1994 WL 326868 (No. 94-0615); *cf.* Banghart v. Hollywood Gen. Partnership, 902 F.2d 805, 808 (10th Cir. 1990) (stating that when a partnership agreement allocates powers to general partners and those powers provide the general partners with the ability to protect their investment, then the presumption is that the partnership is not a security).

182. *See, e.g.*, Defendants' Memorandum in Vision at 19, 1994 WL 326868 (No. 94-0615); *cf.* Williamson v. Tucker, 645 F.2d 404, 423 (5th Cir.) ("The delegation of rights and duties [by partners]—standing alone—does not give rise to the sort of dependence on others which underlies the third prong of the Howey test."), *cert. denied*, 454 U.S. 897 (1981).

183. *See, e.g.*, Defendants' Memorandum in Vision at 16-19, 24, 1994 WL 326868 (No. 94-0615); *cf. Banghart*, 902 F.2d at 808.

184. *See, e.g., supra* note 172.

state regulators charge that interests in such LLCs are securities since the members expect to receive profits from the efforts of others.[185] In making their case that such members are in fact relying on the efforts of others, the SEC and state prosecutors have focused on three factors: (1) the lack of sophistication of certain investors; (2) the special management or entrepreneurial skill supplied by promoters or third parties; and (3) the lack of control the investors have over the investment as a practical matter.[186]

For example, in many of the LLC communications ventures targeted by the SEC and state regulators, prosecutors claimed investors had little or no business experience.[187] Members included retirees, clerical workers, and blue-collar workers unfamiliar with business operations or communications technology.[188] The promotional materials distributed to investors often touted the experience and background of the management team and even informed investors that their roles would be similar to shareholders.[189] While the operating documents were carefully drafted so that members retained certain management powers,[190] prosecutors argued that the investors had no practical control over their investment.[191] Prosecutors maintained that because members were so inexperienced and unknowledgeable in business, they were incapable of intelligently exercising any managerial control.[192] As a result, members were dependent on the promoters or managers. The SEC also charged that the promoters solicited primarily unsophisticated, individual investors who were geographically dispersed. Given the number of investors, the comparatively small size of each investment, and the geographic distribution of investors, the SEC argued it was highly unlikely such investors could exercise any meaningful control over the LLC.[193] The SEC therefore concluded that the investors were required to rely on the efforts of others.[194]

(a) Partnership Case Law

In support of their position that such LLC interests are securities, prosecutors have relied on a line of cases that deals with when partnership interests

185. *See, e.g.*, Plaintiff's Memorandum in Vision at 14-15, 1994 WL 326868 (No. 94-0615); Plaintiff's Memorandum in Parkersburg at 14-15, (No. 94-1079).

186. Commentator Carl Schneider has noted that in applying the fourth prong of the *Howey* test, courts may examine any or all of these three factors. Schneider, *supra* note 134, at 122. In its briefs, the SEC has focused on all three factors. *See, e.g.*, Plaintiff's Memorandum in Vision at 12-13, 1994 WL 326868 (No. 94-0615); Plaintiff's Memorandum in Parkersburg at 14-15, (No. 94-1079); *see also* Illinois Express Action at *4, *14, 1993 WL 566300 (No. 9200106).

187. *See, e.g.*, Plaintiff's Memorandum in Vision at 2, 12, 1994 WL 326868 (No. 94-0615).

188. *See, e.g.*, Plaintiff's Reply Memorandum in Vision at 3-4, 1994 WL 326868 (No. 94-0615).

189. *See, e.g.*, Plaintiff's Memorandum in Vision at 4, 12, 1994 WL 326868 (No. 94-0615).

190. *Id.* at 13.

191. *Id.*

192. *Id.*

193. *Id.*; *cf.* Williamson v. Tucker, 645 F.2d 404, 423 (5th Cir.) (stating that with respect to partnership interests, "at some point there would be so many partners that a partnership vote would be more like a corporate vote, each partner's role having been diluted to the level of a single shareholder in a corporation"), *cert. denied*, 454 U.S. 897 (1981).

194. Plaintiff's Memorandum in Vision at 12, 1994 WL 326868 (No. 94-0615).

and joint ventures interests may be securities.[195] These cases focus primarily on the economic reality of the transaction and the relationship among investors. The seminal case in this area is *Williamson v. Tucker*.[196] In *Williamson*, the court noted that even if the investor retains some managerial control, the investment may still be a security if the investor can demonstrate "he was so dependent on the promoter or on a third party that he was in fact unable to exercise meaningful [managerial] powers."[197] The *Williamson* court described three situations where such an interest may constitute a security: (1) if the agreement among the parties leaves so little power in the hands of the investors that the arrangement distributes power as would a limited partnership; (2) if the investor is "so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising" his managerial powers; and (3) if the investor is "so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful" managerial power.[198] The *Williamson* court also recognized that other factors could give rise to dependence on the promoter or manager so that the exercise of control would be effectively precluded.[199]

In support of their contention that certain LLC interests may be securities, prosecutors cite cases[200] such as *Siebel v. Scott*,[201] *SEC v. Professional Associates*,[202] *SEC v. International Loan Network, Inc.*,[203] and *SEC v. Aqua-Sonic Products Corp.*[204] In *Siebel*, the Fifth Circuit held that limited partnership interests in a cable television system were securities because the limited partners did not plan or desire to participate in the operation of the system and viewed themselves as simply investors relying on the managerial skills of the general partner to bring in profits.[205] In *Professional Associates*, the Sixth Circuit held that there was sufficient evidence to support a finding that interests in a joint venture to exploit leased phonographic master tapes were securities because at least some of the investors were entirely passive and relied on the expected efforts and expertise of the venture's manager.[206] In *International Loan Network*, the Circuit Court for the District of Columbia held that an investment in a financial distribution network constituted a security because investors looked predominantly to others to generate profits.[207] In *Aqua-Sonic Products Corp.*, the Second Circuit held that licenses for the sale

195. *See, e.g.*, Plaintiff's Memorandum in Vision at 12-13, 1994 WL 326868 (No. 94-0615); Plaintiff's Memorandum in Parkersburg at 14-16, (No. 94-1079).

196. 645 F.2d 404 (5th Cir.) (analyzing whether the purchase of joint venture interests in parcels of undeveloped real estate were securities), *cert. denied*, 454 U.S. 897 (1981).

197. *Williamson*, 645 F.2d at 424.

198. *Id.*

199. *Id.* at 424 n.15.

200. *See supra* note 195.

201. 725 F.2d 995 (5th Cir.), *cert. denied*, 467 U.S. 1242 (1984).

202. 731 F.2d 349 (6th Cir. 1984).

203. 968 F.2d 1304 (D.C. Cir. 1992).

204. 687 F.2d 577 (2d Cir.), *cert. denied sub nom.* Hecht v. SEC, 459 U.S. 1086 (1982).

205. *Siebel*, 725 F.2d at 998-99.

206. *Professional Assocs.*, 731 F.2d at 357.

207. *International Loan Network*, 968 F.2d at 1308.

of certain dental devices were securities, even though investors retained some legal rights over distribution, because the promoters of the scheme sought to attract only passive investors.[208]

(b) State Interpretative Opinions

Prosecutors' arguments are bolstered further by interpretative opinions issued by state securities regulators. A 1993 survey of state securities regulators indicated that as many as fourteen state securities agencies had taken the position, either formally or informally, that LLC interests may be investment contracts under their state securities laws.[209] A more recent survey of state securities regulators and state policy statements indicates that now at least twenty state securities agencies have taken that position, either formally or informally.[210] Of these, at least ten state regulatory agencies have issued formal opinions stating that LLC interests may be securities under their state laws.[211] State securities agencies in nine states have stated in policy statements, opinions or no-action letters that whether an LLC interest is a security in their state turns on the facts-and-circumstances investment contract analysis.[212] Specifically, the key issue is whether profits are expected to be derived substantially through the efforts of others.[213] These opinions indicate

208. *Aqua-Sonic Prods. Corp.*, 687 F.2d at 585.

209. *See* Sargent Blue Sky, *supra* note 7, at 431 & n.14.

210. *See* 1 Blue Sky L. Rep. (CCH) ¶ 6551.

211. Limited liability company interpretative release, 1A Blue Sky L. Rep. (CCH) ¶ 14,562 (Conn. Aug. 24, 1994) [hereinafter Connecticut Release]; Statement of policy on classification of limited liability company interests as securities, 1A Blue Sky L. Rep. (CCH) ¶ 24,681 (Ind. Sept. 20, 1993) [hereinafter Indiana Policy Statement]; Interpretative Opinion Orchards Drug, L.C., 1991 WL 101804 (Kan. Sec. Comm'r) (May 1, 1991) [hereinafter Kansas Interpretative Opinion]; Exemption for professional limited liability companies, 2 Blue Sky L. Rep. (CCH) ¶ 32,630 (Mich. Mar. 24, 1994) [hereinafter Michigan Exemptive Order]; Interpretive Opinion, Lindquist, Vennum Professional Ltd. Liab. Co. (Minn. Dep't Comm.) (Dec. 27, 1993) [hereinafter Minnesota Interpretive Opinion]; Opinion Letter, H-I Missoula, LLC (Mont. Sec. Dep't) (June 15, 1995) [hereinafter Montana Opinion Letter]; Exemption request—Offers of interests in limited liability company, 2 Blue Sky L. Rep. (CCH) ¶ 40,642 (N.J. Bureau of Sec.) (July 27, 1994) [hereinafter New Jersey Exemption Request]; Exemption request—Membership interests in a limited liability company, 2A Blue Sky L. Rep. (CCH) ¶ 46,664 (Okla. Dep't of Sec.) (Aug. 28, 1992) [hereinafter Oklahoma Exemption Request]; Statement of Policy 95-2—Limited liability company membership interest as securities, 2A Blue Sky L. Rep. (CCH) ¶ 51,580 (S.C. Secretary of State and Sec. Comm'r) (June, 1995) [hereinafter South Carolina Statement of Policy]; Limited liability company interests as securities, 2A Blue Sky L. Rep. (CCH) ¶ 54,521 (Tenn. Mar. 7, 1995) [hereinafter Tennessee Statement of Policy]. See *infra* Table III pp. 502-05 for a summary of state policy statements, interpretative opinions and no-action letters.

212. *See* Connecticut Release, *supra* note 211, at 10,554; Indiana Policy Statement, *supra* note 211, at 19,569-70; Kansas Interpretative Opinion, *supra* note 211, at *2; Minnesota Interpretive Opinion, *supra* note 211; Montana Opinion Letter, *supra* note 211; Oklahoma Exemption Request, *supra* note 211, at 41,655-56; Letter from Debra M. Bollinger, Director, S.D. Div. of Sec., to Hon. Thomas C. Barrett, Executive Director of State Bar of S.D. (May 16, 1995) [hereinafter South Dakota Letter]; Tenessee Statement of Policy, *supra* note 211, at 48,559-60; Draft Interpretative Opinion Letter, Are Limited Liability Company Memberships Securities?, at 1 (Wyo. Secretary of State) (July 16, 1993) (in-house opinion drafted by staff members of the Wyoming Securities Division and has not been released as a formal legal opinion of the Wyoming Attorney General's office) [hereinafter Wyoming Draft Opinion].

213. *See* Connecticut Release, *supra* note 211, at 10,554; Indiana Policy Statement, *supra* note 211, at 19,570-71; Kansas Interpretative Opinion, *supra* note 211, at *2; Minnesota Interpre-

that the determination depends not only on the legal control granted in the operating documents but also on the member's actual ability and opportunity to exercise such powers in a meaningful way.[214]

(c) State Litigation

In addition, at least twelve states have ordered certain LLC promoters to cease and desist from offering or selling LLC interests in violation of state securities acts.[215] The majority of these cases involved the issuance of summary cease and desist orders, where no opinion was issued, but sufficient evidence was found to conclude a violation of the securities laws occurred.[216] Often the trier of fact either cited no legal theory[217] or simply made a conclusory finding that the LLC interest constituted an investment contract.[218] Nevertheless, these decisions are significant because the sanctions applied indicate the state court or state administrative authority found that the LLC interests constituted securities and usually made such findings based on an investment contract analysis.[219]

(d) State Administrative Decisions

While there have been no reported judicial decisions analyzing the grounds upon which LLC interests have been found to be securities,[220] administrative decisions issued by hearing officers in Illinois and Georgia provide detailed analysis and reasoned opinions that preview the battleground for future litigation.[221] In those state enforcement proceedings, the hearing officers found the LLC interests constituted securities under state securities law by

---

tive Opinion, *supra* note 211, at 2; Montana Opinion Letter, *supra* note 211, at 2; Oklahoma Exemption Request, *supra* note 211, at 41,655-56; South Dakota Letter, *supra* note 212, at 2; Tennessee Statement of Policy, *supra* note 211, at 48,559-60; Wyoming Draft Opinion, *supra* note 212, at 1, 4.

214. *See* Connecticut Release, *supra* note 211, at 10,554; Indiana Policy Statement, *supra* note 211, at 19,570-71; Kansas Interpretative Opinion, *supra* note 211, at *2; Oklahoma Exemption Request, *supra* note 211, at 41,656; South Dakota Letter, *supra* note 212, at 2; Tennessee Statement of Policy, *supra* note 211, at 48,560; Wyoming Draft Opinion, *supra* note 212, at 5.

215. *See infra* Table I pp. 495-98 for a summary of state actions under state securities laws against defendants offering or selling LLC interests (see columns labeled "Action" and "Action Taken" for citations to applicable authorities).

216. *See, e.g.*, Feigin v. Infotech Group, Inc., No. 94 CV 1756, 1994 Colo. Sec. LEXIS 1, at *1-*6 (Apr. 8, 1994); *In re* Express Communications, Inc., No. 93-0027 CD, 1993 Ind. Sec. LEXIS 46, at *1-*12 (Mar. 23, 1993).

217. *See, e.g., In re* Replen-K, Inc., Nos. SE 9209063, SE 9301897, SE 9304735, 1993 WL 451199 (Minn. Dep't Comm.) (Oct. 7, 1993); *In re* UEG, L.C., No. 93E068, 1993 WL 208898 (Kan. Sec. Comm'r) (May 12, 1993).

218. *See, e.g., In re* Hancock Communications Riverside PCS, No. 93E-058, 1993 WL 145928 (Kan. Sec. Comm'r) (Apr. 14, 1993); *In re* Parkersburg Wireless, LLC, No. 9403-11, 1994 WL 125846 (Pa. Sec. Comm'n) (Apr. 6, 1994).

219. *See infra* Table I pp. 495-98 (see columns labeled "Action," "Action Taken," and "Legal Theories Discussed").

220. SARGENT HANDBOOK, *supra* note 1, § 4.03[1][b], at 4-18; Georgia Express Action at 40, (No. 50-93-0075).

221. Georgia Express Action at 34-64, (No. 50-93-0075); Illinois Express Action at *9-*17, 1993 WL 566300 (No. 9200106).

applying the investment contract test.[222] Both hearing officers applied the definition of investment contract set forth in *Howey* and its progeny as adopted in each state[223] and focused primarily on the element of reliance on the efforts of others.[224] Both hearing officers discussed general partnership cases,[225] including the language and exceptions stated in *Williamson v. Tucker*.[226] In the Georgia enforcement action, the hearing officer found that although each member had the power to make managerial decisions for the LLC, the members could not effectively exercise control because they lived in diverse geographic areas, and lacked technical expertise and business experience.[227] Because the members were incapable of exercising the illusory powers granted to them, they were placed in the position of relying on the expertise and managerial abilities of others.[228] Similarly, in the Illinois enforcement action, the hearing officer found that even though the investor was offered the opportunity to become an officer of the LLC, he was unsophisticated and believed himself to be in the hands of an expert that would take care of matters for him.[229] As a result, he could effectively exercise his managerial rights only with the expert advice of others.[230]

[3] Summary

Under the *Howey* investment contract test, an LLC interest is a security if a person invests money in a common enterprise with the expectation of profits from the entrepreneurial or managerial efforts of others.[231] In the cases to date involving LLC interests, the battle has been waged over whether investors expected profits from the efforts of others.[232] To support their position that certain LLC interests are securities, prosecutors have focused on the economic realities of the transaction to demonstrate that LLC members relied on the efforts of others.[233] Prosecutors have pointed to: (1) the lack of sophistication of certain investors; (2) the special management or entrepreneurial skills supplied by third parties; and (3) the lack of control investors had over the invest-

222. Georgia Express Action at 61, (No. 50-93-0075); Illinois Express Action at *8, 1993 WL 566300 (No. 9200106).

223. Georgia Express Action at 51-61, (No. 50-93-0075); Illinois Express Action at *9, *15-*16, 1993 WL 566300 (No. 9200106).

224. Georgia Express Action at 57-61, (No. 50-93-0075); Illinois Express Action at *13-*14, *16, 1993 WL 566300 (No. 9200106).

225. Georgia Express Action at 58-60, (No. 50-93-0075); Illinois Express Action at *11-*13, 1993 WL 566300 (No. 9200106).

226. Georgia Express Action at 58-60, (No. 50-93-0075); Illinois Express Action at *12, 1993 WL 566300 (No. 9200106).

227. Georgia Express Action at 60, (No. 50-93-0075).

228. *Id.* at 60-61.

229. Illinois Express Action at *16, 1993 WL 566300 (No. 9200106).

230. *Id.*

231. *See supra* notes 122-23, 161-62 and accompanying text.

232. *See, e.g.*, Defendants' Memorandum in Vision at 12-24, 1994 WL 326868 (No. 94-0615) (contending that the LLC interests at issue are not investment contracts only because they do not meet the profits from the efforts of others element of the *Howey* test); Defendants' Memorandum in Parkersburg at 13-30, (No. 94-1079) (contending the LLC interests at issue are not investment contracts, but focusing only on the efforts of others element of the *Howey* test).

233. *See supra* notes 184-94 and accompanying text.

ment as a practical matter.[234] Prosecutors have relied on the *Williamson* case and its progeny which detail the circumstances whereby partnership interests and joint venture interests may be securities.[235] Prosecutors' arguments have been bolstered by interpretative opinions issued by state securities regulators, the many cease and desist orders issued in state enforcement actions, and the two administrative decisions that were issued in state enforcement actions.[236]

2. Possible Defenses

Commentators and even LLC promoters concede that typically LLC interests meet the first three prongs of the *Howey* investment contract test.[237] The purchase of LLC interests generally involve an investment of money in a common enterprise with an expectation of profits. As a result, the critical issue in determining whether an LLC interest is a security becomes whether profits are expected solely or substantially from the efforts of others.[238]

But some commentators and LLC promoters contend that there should be a presumption against characterizing LLC interests as securities.[239] They argue courts have held that general partners in a general partnership are not solely or substantially dependent on the efforts of others when, under state partnership law or a partnership agreement, partners retain the ultimate power to control the business.[240] Several courts have stated there is a strong presumption that general partnership interests are not securities under the *Howey* test.[241] Further, courts have stated that an investor who claims a general part-

234. *See supra* notes 186-94 and accompanying text.

235. *See supra* notes 195-208 and accompanying text.

236. *See supra* notes 209-30 and accompanying text.

237. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-2; SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-10; Defendants' Memorandum in Vision at 12-24, 1994 WL 326868 (No. 94-0615) (contending that the LLC interests at issue are not investment contracts only because they fail to meet the profits from the efforts of others element of the *Howey* test); Defendants' Memorandum in Parkersburg at 13-30, (No. 94-1079) (contending that the LLC interests at issue are not investment contracts, but focusing only on the efforts of others element of the *Howey* test). The *Howey* test for an investment contract is set forth in the text accompanying *supra* notes 122-23.

238. See text accompanying *supra* notes 158-63 for court interpretations of the *Howey* test's "solely from the efforts of others" prong.

239. *See, e.g.*, 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-5; SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-11.

240. *See, e.g.*, 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-3 to 14-4; SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-10; Defendants' Memorandum in Vision at 13, 1994 WL 326868 (No. 94-0615); Defendants Memorandum in Parkersburg at 13-14, (No. 94-1079). Commentators and LLC promoters cite cases such as Banghart v. Hollywood Gen. Partnership, 902 F.2d 805, 808 (10th Cir. 1990) (whether the interest is a security turns on the partnership agreement); Reeves v. Teuscher, 881 F.2d 1495, 1500 (9th Cir. 1989) (observing that "the proper focus must be on the partnership agreement and not how . . . the entity functioned"); Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc., 840 F.2d 236, 241-42 (4th Cir. 1988) (interest not a security because the partnership agreement conferred broad authority to manage and control the business); Goodwin v. Elkins & Co., 730 F.2d 99, 107 (3d Cir.) (must read the statute and the private agreement to determine legal powers vested), *cert. denied*, 469 U.S. 831 (1984); Odom v. Slavik, 703 F.2d 212, 216 (6th Cir. 1983) (indicating that the issue is whether the general partner had power under the partnership agreement and state partnership laws).

241. Defendants' Memorandum in Parkersburg at 14, (No. 94-1079) (citing *Banghart*, 902 F.2d at 808); *see also* Youmans v. Simon, 791 F.2d 341, 346 (5th Cir. 1986); 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-3 to 14-4 (the general partnership form is close to a per se

nership interest is an investment contract has a difficult burden to overcome.[242] These commentators and LLC promoters assert that LLCs are closely analogous to general partnerships.[243] They claim LLCs share the same critical features as general partnerships.[244] In both entities, investors have the power to participate in the management of the entity.[245] Most LLC statutes, for example, provide that the LLC will be member-managed unless the articles of organization provide otherwise.[246] LLC members normally have the power to elect and remove managers.[247] LLC members also have the authority to bind the entity.[248] Moreover, there are tax risks associated with delegating authority to managers which create an incentive for member-management.[249] Since both LLCs and general partnerships allow for investor participation in management decision-making, they argue that profits are not expected solely or substantially from the efforts of others; therefore, there should be a strong presumption against characterizing LLC interests as securities under the *Howey* investment contract test.[250]

In support of their position that LLC interests should not be treated as securities, LLC promoters have relied on cases that have held that general partnership interests were not securities because the partners had the power to manage the business either under the state partnership statute or the partnership agreement.[251] These courts reason that such investors do not require the protection of the securities laws because the investors have the ability to take care of their own interests due to the inherent powers such investors have

---

nonsecurity); SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-10 ("General partnership interests are virtually presumed not to be securities . . . .").

242. *See, e.g.*, *Youmans*, 791 F.2d at 346; Williamson v. Tucker, 645 F.2d 404, 425 (5th Cir.), *cert. denied*, 454 U.S. 897 (1981).

243. *See, e.g.*, 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-3 to 14-4; SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-11.

244. *See supra* note 243.

245. *See supra* note 243.

246. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 1.05, at 1-4; SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-11; Keatinge et al., *supra* note 1, at 390.

247. SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-11.

248. *Id.*

249. Internal Revenue Service Treasury Regulations use certain characteristics to distinguish entities treated as partnerships for federal income tax purposes from entities treated as associations taxable as corporations. Those characteristics include: (i) continuity of life; (ii) centralized management; (iii) limited liability; and (iv) free transferability of interests. Treas. Reg. § 301.7701-2 (as amended in 1993). A business organization is treated as a corporation and not a partnership for federal income tax purposes if it has at least three of these characteristics. *See id.*; *see also* Ribstein, *supra* note 7, at 820-21. As a result, to be classified as a partnership, the entity must lack at least two of these characteristics. Daniel S. Goldberg, *The Tax Treatment of Limited Liability Companies: Law in Search of Policy*, 50 BUS. LAW. 995, 1000 (1995). Since LLCs have limited liability, a centrally-managed LLC would have to lack both continuity of life and free transferability for partnership tax treatment. Given the uncertainty surrounding these characteristics, centrally-managed LLCs would run a greater risk of being denied partnership tax treatment. *See* Ribstein, *supra* note 7, at 820-21; Sargent Article, *supra* note 7, at 1077-78.

250. *See* SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-11; Defendants' Memorandum in Parkersburg at 13-14, (No. 94-1079).

251. *See, e.g.*, Defendants' Memorandum in Vision at 13-22, 1994 WL 326868 (No. 94-0615); Defendants' Memorandum in Parkersburg at 13-14, (No. 94-1079). For the cases typically cited by such LLC promoters, see *supra* note 240.

under state law or the partnership agreement.[252] For example, general partners may act on behalf of the partnership and bind other partners by their actions.[253] General partners are personally liable for the liabilities of the partnership, and they may dissolve the partnership.[254]

Citing general partnership cases, LLC promoters argue that the *power* to exercise managerial control is determinative, regardless of the control actually exercised.[255] The mere delegation of management control does not create a security.[256] So even if the LLC member does not participate in the management of the business, the retention of control under a statute, the articles of organization, or the operating agreement precludes finding a security. LLC promoters often set forth a litany of examples to illustrate LLC members retained the legal right to manage the entity, despite the delegation of authority to a management group. In *Vision Communications*, for example, the LLC promoters cited, among other things, the fact that members had the express authority under the operating agreement: (i) to convert the manager-managed LLC to a member-managed LLC; (ii) to terminate the management agreement; (iii) to elect managers; and (iv) to participate in the management and control of the LLC in proportion to the number of membership interests owned.[257] In *Parkersburg*, the LLC promoters cited, among other things, that the operating agreement provided: (i) each member had the right to participate in the management and control of the company in proportion to the number of membership interests owned; (ii) members had the power to remove managers; (iii) unanimous consent of the members was required for dissolution; and (iv) majority consent was required for acquisition or disposition of any license or equity interest in entities owning and operating wireless cable systems.[258]

Prosecutors counter that the grant of certain management powers to members should not immunize an LLC from charges that its interests are securities.[259] Even if there were a presumption that such interests were not securities, in the general partnership cases courts have held that the presumption may be overcome when a *Williamson*-type analysis indicates the investor is so unsophisticated, inexperienced, uninformed, or dependent on others that the investor is unable to exercise meaningful control.[260] As a result, the

252. *See, e.g.*, Youmans v. Simon, 791 F.2d 341, 346 (5th Cir. 1986).

253. *Id.*

254. *Id.*

255. *See, e.g.*, Banghart v. Hollywood Gen. Partnership, 902 F.2d 805, 808 (10th Cir. 1990); Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc., 840 F.2d 236, 240-41 (4th Cir. 1988) (quoting *Williamson*); Goodwin v. Elkins & Co., 730 F.2d 99, 107 (3d Cir.), *cert. denied*, 469 U.S. 831 (1984).

256. *See, e.g., Rivanna*, 840 F.2d at 240-41; New York Stock Exchange, Inc. v. Sloan, 394 F. Supp. 1303, 1314 (S.D.N.Y. 1975) ("The fact that a partner may choose to delegate his day-to-day managerial responsibilities to a committee does not diminish in the least his legal right to a voice in partnership matters, nor his responsibility under state law for acts of the partnership.").

257. *See* Defendants' Memorandum in Vision at 17-19, 1994 WL 326868 (No. 94-0615).

258. *See* Defendants' Memorandum in Parkersburg at 15-18, (No. 94-1079).

259. *See supra* notes 184-208 and accompanying text.

260. SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-11; *see* Williamson v. Tucker, 645 F.2d 404, 424 (5th Cir.), *cert. denied*, 454 U.S. 897 (1981).

investor's *ability* to exercise meaningful control is determinative, not merely the grant of such control.

LLC promoters respond that the knowledge and sophistication of an individual member should not determine whether an interest is a security.[261] First, if the knowledge and sophistication of an individual member is determinative, whether a promoter is selling a security would turn on the identity of the purchaser.[262] This would unduly burden promoters by requiring them to investigate the business experience and knowledge of all potential investors. Such a litmus test would create uncertainty. Also, the promoter could find himself offering a security to some investors (the "unsophisticated" investors), but offering a nonsecurity to other investors (the "knowledgeable and sophisticated" investors). Second, in the general partnership cases, courts have indicated that investors who lack financial sophistication or expertise may still exercise meaningful control, because they are free to consult with more knowledgeable investors or third persons, or to employ accountants and lawyers.[263] Consequently, an individual's business sophistication should not be determinative.

On theoretical grounds, Professor Larry Ribstein argues that courts should strongly presume LLC interests are not securities.[264] Professor Ribstein criticizes the *Howey* approach and other cases which emphasize "economic reality" and "substance-over-form" because such tests require courts to conduct a fact-specific inquiry into each transaction.[265] Such tests become subjective and often lead to anomalous results.[266] Consequently, neither investors nor issuers know without litigation whether the securities laws apply.[267] This unpredictability increases litigation, makes it difficult for parties to make and price contracts, decreases the probability of settling disputes without litigation, and inhibits capital formation.[268] Professor Ribstein asserts that the form of the investment, rather than the substance or economic reality, should determine whether an interest is a security.[269] A strong presumption that LLC interests are not securities would provide a clear and predictable rule, reduce litigation, and decrease associated costs.[270] Moreover, a presumption based on the form

---

261. *See, e.g.*, Defendants' Memorandum in Vision at 20-21, 1994 WL 326868 (No. 94-0615).

262. Matek v. Murat, 862 F.2d 720, 729 (9th Cir. 1988) (discussing this issue in connection with whether a general partnership interest is a security); *Rivanna*, 840 F.2d at 241 n.7 (also in connection with general partnership interests).

263. *See, e.g.*, Defendants' Memorandum in Vision at 21 n.5, 1994 WL 326868 (No. 94-0615); *see also Banghart*, 902 F.2d at 808 n.5 (citing *Rivanna*); *Rivanna*, 840 F.2d at 242 n.10.

264. Ribstein, *supra* note 7, at 810.

265. *Id.* at 809, 828-29.

266. *See* Schneider, *supra* note 128, at 107-08 (noting the results-orientation of courts); Schneider, *supra* note 134, at 122-27 (noting that the *Howey* test gives courts the power to reach any outcome the court desires in a given case and detailing the various factors that appear to affect court decisions).

267. Ribstein, *supra* note 7, at 809.

268. *Id.* at 809, 828-31.

269. *Id.* at 810, 824.

270. *Id.* at 824-32; *see also* Park McGinty, *What Is a Security?*, 1993 WIS. L. REV. 1033, 1082 (noting that "[p]resumptions are the most effective method for providing predictability" and creating settled expectations).

of the transaction allows the parties themselves to determine the amount of disclosure necessary and whether the securities laws apply.[271]

3. Conclusions

Clearly, LLC interests can be securities under the *Howey* investment contract test.[272] Whether a particular LLC interest is a security under the *Howey* test is a factual question which must be analyzed on a case-by-case basis that typically will focus on whether profits are expected from the efforts of others.[273]

By comparing LLCs to general partnerships, limited partnerships, and corporations, commentators and litigators appear to have missed the mark. The LLC is a hybrid entity that is highly tailorable and flexible.[274] LLC statutes permit promoters to structure an entity so that it may have the characteristics of a general partnership, limited partnership, or corporation, sometimes with characteristics of each.[275] The LLC statutes purposefully permit a wide spectrum of member participation and control.[276] As a result, any attempt to generalize or base presumptions on comparisons to other types of legal entities is doomed to be inaccurate and lead to undesirable results.

In particular, the preoccupation with applying general partnership case law[277] to LLCs appears misguided. While LLC promoters and some commentators would have us believe all LLCs are analogous to general partnerships,[278] LLCs differ from general partnerships in at least two critical repects.[279] First, an LLC member has only limited liability for the debts and obligations of the LLC,[280] whereas a general partner has unlimited personal liability for the debts and obligations of the general partnership.[281] Unlimited personal liability gives a general partner the incentive to be highly informed about the business and the motivation to be actively involved in the management of the general partnership. The risk of unlimited personal liability also discourages involvement by unsophisticated investors.[282] In comparison, an LLC member's liability is limited to his or her investment.[283] Members are not personally liable for the debts and obligations of the LLC. In this respect, members are more like corporate shareholders[284] than general partners. So

271. Ribstein, *supra* note 7, at 812.
272. *See supra* part III.A.1.
273. *See supra* notes 164-73 and accompanying text.
274. SARGENT HANDBOOK, *supra* note 1, § 1.03, at 1-3 to 1-4.
275. *Id.*
276. *Id.* § 4.02[1], at 4-11.
277. Both prosecutors and LLC promoters cite general partnership case law in support of their respective positions. *See supra* notes 195-208, 251-56 and accompanying text.
278. *See supra* notes 243-50 and accompanying text.
279. Ribstein, *supra* note 7, at 816-17 (discussing the differences between general partnerships and LLCs, including investor liability and management structure).
280. LLC members normally are not liable for obligations of the LLC, except to the extent that they personally guarantee the debts of the LLC. SARGENT HANDBOOK, *supra* note 1, § 3.06[1][b]; *see also* 1 RIBSTEIN & KEATINGE, *supra* note 1, § 12.02.
281. SARGENT HANDBOOK, *supra* note 1, § 3.02[2][a].
282. Keatinge et al., *supra* note 1, at 404.
283. *See supra* note 280.
284. *See* SARGENT HANDBOOK, *supra* note 1, § 3.04[1][a] (noting that "[s]hareholders are not

LLC members have less incentive than general partners to investigate or actively participate in the management of the business.[285] LLC members therefore are more likely than general partners to be passive investors, less informed, less sophisticated, and more dependent on the efforts of others.[286]

Second, the LLC statutes provide a formal structure that permits centralized management.[287] LLCs can easily adopt a corporate or limited partnership centralized-management structure in lieu of an investor-managed general partnership structure. An investor in an LLC with centralized management would not expect to participate in management to the same extent as he would in a general partnership.[288] These differences between LLCs and general partnerships promote passive investment and reliance on the efforts of others, major factors that affect whether an interest is a security. Moreover, the enforcement actions to date demonstrate that even when an LLC adopts a member-managed structure, all investors may not be actively involved in the management of the LLC. Courts therefore should not assume that all LLCs are analogous to general partnerships and that all investors are actively involved in the management of the LLC.

In addition, the legal powers granted LLC members do not necessarily bestow meaningful management control. The legal powers granted to LLC members may be no more than the legal powers granted to corporate shareholders.[289] In the *Vision Communications* and *Parkersburg* cases, LLC promoters claimed LLC members had the power to control the entity because, among other things, LLC members could vote to elect or remove managers and vote on extraordinary decisions, such as amending the articles of organization, dissolution, and the sale of all or substantially all the LLC's assets.[290]

---

liable for the debts of the corporation").

285. *See* Ribstein, *supra* note 7, at 816-17.

286. Professor Mark Sargent dismisses the liability distinction argument as merely a formalistic distinction:

> As a practical matter, investors in such enterprises—whatever the form of business organization—all have substantial incentives "to be highly informed about the business" because their investment is likely to represent a large percentage of their personal wealth, because their position is illiquid since there is no real secondary market for their interests, and because they have often personally guaranteed the business's obligations. It is also by no means clear that the general partnership's lack of limited liability either encourages or discourages "unsophisticated investors." Many unsophisticated investors are attracted to the general partnership form because of its relative simplicity. This purported distinction between the incentives of general partners and LLC investors thus has little bearing on the question of whether LLC members are more or less dependent on the efforts of others, and thus does not undermine our basic conclusion: LLC interests should be presumed not to be investment contracts under the *Howey* test.

SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-13; *see also* Ribstein, *supra* note 7, at 822-23 (arguing that the differences in liability should not make a critical difference in applying the securities laws).

287. *See* Ribstein, *supra* note 7, at 817. "Some LLC statutes provide for corporate-type centralized management." *Id.* Other LLC statutes allow LLC members to "elect to be centrally-managed in their articles of organization or operating agreement." *Id.*; *see supra* notes 167-69 and accompanying text.

288. Ribstein, *supra* note 7, at 817.

289. *See, e.g.*, Long, *supra* note 7, at 112-13 (discussing the rights possessed by the members of Cellvision, a Texas limited liability company).

290. Defendants' Memorandum in Vision at 17-19, 1994 WL 326868 (No. 94-0615);

Such legal rights do not necessarily constitute management control. In effect, these LLC members have no greater rights than most corporate shareholders. Corporate shareholders are allowed to vote to remove directors and are typically granted the right to vote on similar extraordinary corporate matters.[291] A shareholder's possession of such rights usually is not viewed as constituting legal control or participation in the management of the corporation, particularly when he is only one of many shareholders. His shares of stock are securities. Why then should the grant of such rights change an LLC interest from a security to a nonsecurity?

Courts should resist playing into the hands of LLC promoters by applying general partnership case law to determine whether an LLC interest is a security. If you start with the premise that general partnership cases are controlling, prosecutors and civil plaintiffs begin with three strikes against them: (i) a "strong presumption" the interests are not securities;[292] (ii) a "difficult burden to overcome";[293] and (iii) a narrow *Williamson*-type exception that allows the presumption to be overcome in only limited circumstances by showing the member is so unsophisticated, uninformed, or dominated that he is wholly dependent on the manager, or by showing deferral of authority to the manager is so extreme that members essentially have no control.[294] Since LLCs differ from general partnerships in several important repects and the legal powers granted to members may be no more than the corporate power granted to shareholders, there is no reason to saddle prosecutors and plaintiffs with the burdens and baggage of general partnership case law. The *Howey* investment contract test requires a case-by-case analysis.[295] There are no presumptions. There are no narrow exceptions. The test is simply whether there is an investment of money in a common enterprise with the expectation of profits from the efforts of others.

Moreover, the presumptions used in partnership cases, that an interest in a general partnership is not a security and an interest in a limited partnership is a security,[296] are proving less and less useful to courts. Under a *Williamson*-type analysis, courts may find general partnership interests are securities.[297] Revisions to state limited partnership laws now allow limited partners to enjoy some of the same rights traditionally possessed only by general partners.[298] As a result, certain limited partnership interests may not be securities.[299]

Defendants' Memorandum in Parkersburg at 15-18, (No. 94-1079).

291. HARRY G. HENN & JOHN R. ALEXANDER, LAW OF CORPORATIONS 511-12, 957 (3d ed. 1983); Long, *supra* note 7, at 113.

292. *See supra* note 241 and accompanying text.

293. *See supra* note 242 and accompanying text.

294. SARGENT HANDBOOK, *supra* note 1, § 4.02[1], at 4-11.

295. *See supra* notes 123, 165 and accompanying text.

296. *See supra* notes 175-80 (limited partnership interests), 241-42 (general partnership interests) and accompanying text.

297. *See supra* notes 195-99 and accompanying text; *see also* 2 LOSS & SELIGMAN, *supra* note 99, at 958-59 & n.203.

298. Conrad E.J. Everhard, *The Limited Partnership Interest: Is It a Security? Changing Times*, 17 DEL. J. CORP. L. 441, 482 (1992); *see also* 2 LOSS & SELIGMAN, *supra* note 99, at 959 n.203, 960 & n.204, 961 n.211.

299. Everhard, *supra* note 298, at 466-68.

These presumptions are losing their relevance. Instead, courts must analyze each partnership on a case-by-case basis. So why attempt to impose presumptions that are not determinative or necessarily useful in partnership cases in LLC cases? Furthermore, the courts' inability to clearly specify the characteristics which can overcome such presumptions creates practical problems in terms of application and anomalous results.

Applying general partnership case law to LLCs does not appear to be a satisfactory solution on theoretical grounds either. The strict literalist approach some federal courts have taken in general partnership cases has been criticized for focusing on the form of the transaction and legal powers retained by investors, rather than the economic reality of the transaction.[300] LLC promoters tend to cite cases such as *Rivanna*, *Banghart*, and *Goodwin* in support of their contention that the legal power to control an entity should determine whether an interest is a security.[301] But such cases look to the form of the transaction,[302] which is contrary to the Supreme Court's constant admonishments to look at substance rather than form.[303] Courts have begun to reject or limit the prior authority that focused on form and restricted the scope of the "efforts of others" inquiry to the legal powers retained by investors.[304] Now the trend is to recognize that investor control depends not only on the form of the transaction and legal powers granted in the documents, but the investor's actual ability and opportunity to exercise management powers.[305] Courts have begun to return to this case-by-case "economic realities" approach.

To date, commentators, prosecutors, and LLC promoters have all overemphasized the provisions in the articles of organization and the operating agreements.[306] The undue emphasis on the grant of power is not only at odds with prior Supreme Court precedent,[307] but invites promoters to try to escape the securities laws by merely parceling out duties to investors and using

---

300. *See, e.g.*, Douglas M. Branson & Karl S. Okamoto, *The Supreme Court's Literalism and the Definition of "Security" in the State Courts*, 50 WASH. & LEE L. REV. 1043, 1076-77 (1993).

301. *See supra* notes 255-56 and accompanying text.

302. *See supra* note 255.

303. *See, e.g.*, Tcherepnin v. Knight, 389 U.S. 332, 336 (1967); SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946).

304. *See, e.g.*, Koch v. Hankins, 928 F.2d 1471, 1475-81 (9th Cir. 1991) (rejecting the district court's reliance on Matek v. Murat, 862 F.2d 720 (9th Cir. 1988), and stating, "[t]he question of investor's control . . . is decided in terms of practical as well as legal ability to control"); Bailey v. J.W.K. Properties, Inc., 904 F.2d 918, 921-25 & n.6 (4th Cir. 1990) (questioning the district court's application of Rivanna Trawlers Unlimited v. Thompson Trawlers, Inc., 840 F.2d 236 (4th Cir. 1988) and holding that the district court improperly limited its examination to the language of the contracts and should have considered the practical limitations on the investor's ability to exercise meaningful control). Also, the Tenth Circuit case, *Banghart*, relies on the *Matek* decision which has been undercut and discredited by more recent Ninth Circuit opinions such as Holden v. Hagopian, 978 F.2d 1115, 1119 (9th Cir. 1992); *Koch*, 928 F.2d at 1475-81; Hocking v. Dubois, 885 F.2d 1449, 1460 (9th Cir. 1989), *cert. denied*, 494 U.S. 1078 (1990). *See Banghart*, 902 F.2d at 808 (citing *Matek* and *Rivanna*). For a discussion of the trends in general partnership case law, see Branson & Okamoto, *supra* note 300, at 1076-88.

305. *See* Everhard, *supra* note 298, at 448-49; Steinberg Article, *supra* note 7, at 1111-12.

306. For example, see the following discussions focusing on provisions in the articles of organization and operating agreements: Defendants' Memorandum in Vision at 17-19, 1994 WL 326868 (No. 94-0615); Defendants' Memorandum in Parkersburg at 15-18, (No. 94-1079); Steinberg Article, *supra* note 7, at 1112-13.

307. *See supra* note 303 and accompanying text.

boilerplate provisions to protect against securities law violations.[308] Promoters should not be allowed to hide behind documents that grant powers that are not intended to be used, cannot practically be used, or have never been used.[309] A strict contractual interpretation of documents results in a mechanical, underinclusive, and unduly restrictive view of a security that frustrates the remedial purposes of the securities laws.[310] The key issue in the *Howey* test is whether the investor in the LLC is led to expect profits from the entrepreneurial or managerial efforts of others, not the legal power retained.

The United States Supreme Court has not yet considered whether general partnership interests are securities or whether any presumptions are warranted. Given the limited usefulness of these presumptions in partnership cases,[311] the inappropriate focus they place on the form of the transaction and the legal rights retained by investors,[312] the practical problems with clearly specifying the characteristics which can overcome such presumptions, and the potential to frustrate the remedial purposes of the securities laws,[313] it appears applying general partnership case law to LLCs does not present a satisfactory solution from either a practical or theoretical standpoint. For the securities laws to keep pace with ever-changing investment structures, the courts must return to the basic premise of the *Howey* test which requires case-by-case analysis and a focus on the economic realities.[314]

Professor Ribstein advocates on theoretical grounds that there should be a strong presumption LLCs are not securities.[315] He claims such a presumption would provide a clear and predictable rule, reduce litigation, decrease the cost of capital formation, and allow parties themselves to determine whether the securities laws apply by their choice of entity.[316] But such a presumption sacrifices investor protection to save costs and provide docket control. Legislatures passed securities acts to provide broad investor protection.[317] In *Howey*, the Supreme Court stated investor protection should not be thwarted by formulas[318] and instead adopted a case-by-case analysis approach.[319] A strong presumption for convenience and cost-cutting is the type of formula the Supreme Court attempted to avoid with *Howey*.

---

308. *See* SEC v. Aqua-Sonic Prods. Corp., 687 F.2d 577, 584 (2d Cir.) (discussion in connection with analysis of licenses for sale), *cert. denied sub nom.* Hecht v. SEC, 459 U.S. 1086 (1982); Probst v. State, 807 P.2d 279, 284 (Okla. Crim. App. 1991) (discussion in connection with analysis of limited partnership interest).

309. *Probst*, 807 P.2d at 285.

310. *Id.* at 288 (Lane, J., concurring).

311. *See supra* notes 296-99 and accompanying text.

312. *See supra* notes 300-04 and accompanying text.

313. *See supra* notes 300-10 and accompanying text.

314. *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 851-52 (1975) (stating that in applying *Howey* and determining what is an investment contract we "must examine the substance—the economic realities of the transaction—rather than the names that may have been employed by the parties"); *accord* International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 558 (1979); *see also supra* note 303.

315. *See supra* notes 264-67 and accompanying text.

316. *See supra* notes 268-71 and accompanying text.

317. *See, e.g.*, SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

318. *Id.*

319. *See id.* at 298-301.

A strong presumption that LLCs are not securities would allow promoters to choose to avoid the securities laws by choosing the form of the legal entity.[320] Such a presumption could affect a promoter's choice of entity decision by providing promoters with an incentive to form an LLC rather than a corporation. Moreover, such a presumption would encourage every dishonest promoter to structure his transactions as an LLC.[321] State regulators already charge that many promoters are now packaging their investment products as LLCs in an attempt to avoid state and federal securities laws.[322] If, as Professor Ribstein advocates, the courts allow private ordering,[323] who will suffer? Private ordering invites fraudulent promoters to prey on the unsophisticated and uninformed. The effect of such a presumption is to leave those investors who are least able to protect themselves vulnerable to the schemes of clever promoters.

If there is a need for a clear, predictable rule to reduce litigation and decrease the cost of capital formation, a presumption that LLC interests *are* securities would better serve the purposes of the securities laws than a presumption that LLC interests are not securities. The hybrid nature of the entity, the wide variations in the number of investors and management structure, and the potential for abuse compel such a conclusion. A presumption that LLC interests are securities would provide a clear, predictable rule.[324] Parties could better predict the outcome of litigation. This would reduce litigation and make it easier for parties to make and price contracts. As for the cost of complying with the securities laws, for many ventures the cost would be minimal. If the number of LLC members are limited and all members are active and well-informed, such an offering usually would qualify for an exemption from the registration provisions of the securities acts.[325] In many situations, the

---

320. *See* Ribstein, *supra* note 7, at 810, 812 (advocating a "private ordering" approach where parties could determine whether the securities laws applied by selecting the form of the transaction).

321. *Cf.* Branson & Okamoto, *supra* note 300, at 1081 (observing that once courts began presuming general partnership interests were not securities, "[e]very promoter who knew what she was doing, or who had a decently schooled transactional lawyer, structured their deal as a general partnership").

322. Emshwiller, *supra* note 5; Emshwiller, *supra* note 11.

323. For a discussion of the "private ordering approach" advocated by Professor Ribstein which would allow private parties to determine whether the securities laws apply, see Ribstein, *supra* note 7, at 812; Larry E. Ribstein, *Private Ordering and the Securities Laws: The Case of General Partnerships*, 42 CASE W. RES. L. REV. 1 (1992).

324. *See* Ribstein, *supra* note 7, at 838-40 (recognizing that changing the definition of a security to include LLCs would reduce predictability problems and litigation costs).

325. Such LLC interests would probably be exempt from registration requirements under the Securities Act as a nonpublic offering, limited offering, or intrastate offering. For a discussion of federal registration exemptions and related disclosure requirements, see STEINBERG, *supra* note 135, §§ 3.01-3.12. For a discussion of state registration exemptions and related disclosure requirements, see 12 LONG, *supra* note 84, at 4-1 to 5-185. As equity securities, the LLC interests would only be subject to the registration provisions of the Exchange Act if there are 500 or more record holders. Registration is required under the Exchange Act only for firms that are listed on an exchange or have total assets exceeding $5 million and equity securities held by more than 500 persons. 15 U.S.C. § 78l(a) (1994) (making it unlawful to effect any transaction in a security on a national exchange unless the security is registered under the Exchange Act); 15 U.S.C. § 78l(g)(1) (requiring registration for companies with assets of more than $1 million and held of record by more than 500 persons); 17 C.F.R. § 240.12g-1 (1995) (exempts issuers with total assets under $5

disclosure requirements of the securities acts would either not apply or the acts would require only limited disclosure.[326] Purchases and sales of LLC interests, however, would be subject to the antifraud provisions of the securities laws.[327] The antifraud provisions provide investors with remedies in the event of misrepresentation, fraud, or deceit.[328] So in most instances, the cost of complying with the securities laws would be minimal, but the protection and safeguards provided to investors would be great.[329] Also, even with the presumption that LLCs are securities, investors would still be allowed to determine whether the securities laws apply. If they did not want the securities laws to apply, they could select the general partnership form, rather than the LLC form. But more importantly, such a presumption would discourage promoters from packaging their investment products as LLCs to avoid the securities laws, encourage compliance with the securities laws, and provide investors greater protection against fraudulent schemes.

LLC interests clearly can be securities under the *Howey* investment contract test.[330] Because the LLC is a hybrid entity, any attempt to generalize or base presumptions on comparisons to other types of legal entities is doomed to be inaccurate and lead to undesirable results.[331] For example, LLCs differ from general partnerships in a number of critical respects that affect whether an interest is a security.[332] Courts should resist applying general partnership case law and its associated presumptions to LLCs.[333] Courts should return to the case-by-case analysis dictated by the *Howey* investment contract test and focus on the economic realities of the transaction.[334] If there is a need for presumptions to provide a clear, predictable rule, courts should presume LLC interests are securities.[335] The costs associated with such a presumption

---

million from registration). *Cf.* 3 BLOOMENTHAL, *supra* note 94, § 2.05[3], at 2-51 (suggesting that if all partnership interests were classified as securities, in most instances, the principal impact would be that the purchase and sale was subject to the antifraud provisions of the securities laws).

326. For a discussion of the federal disclosure requirements associated with various exemptions, see STEINBERG, *supra* note 135, §§ 3.01-3.12. For a discussion of the state disclosure requirements associated with various exemptions, see 12 LONG, *supra* note 84, at 4-1 to 5-185.

327. "The anti-fraud provisions . . . [of the federal securities laws] apply to all sales of securities involving interstate commerce or the mails, whether or not the securities are exempt from registration." STEINBERG, *supra* note 135, ch. 1 app. at 6 (quoting "The Work of the SEC," published by the SEC in 1982).

328. For a discussion of the antifraud provisions of the Securities Act and the Exchange Act, see STEINBERG, *supra* note 135, §§ 6.01-7.12.

329. *Contra* Goforth, *supra* note 7, at 1278-88; *see also* Sargent Blue Sky, *supra* note 7, at 438-39. After a thoughtful discussion of the benefits and costs of federal securities law regulation, Professor Goforth concludes that the likely costs of regulation and other potential consequences far exceed any potential benefits. Goforth, *supra* note 7, at 1278-88. Professor Sargent argues that a "rule defining all LLC interests as securities would be overinclusive. It is difficult to justify imposing all of the consequences of securities status on an entity with a small number of members, all of whom are legally and practically capable of participating in control." Sargent Blue Sky, *supra* note 7, at 438-39.

330. *See supra* part III.A.1.

331. *See supra* notes 274-76 and accompanying text.

332. *See supra* notes 279-88 and accompanying text.

333. *See supra* notes 292-314 and accompanying text.

334. *See supra* notes 303-14 and accompanying text.

335. *See supra* notes 324-29 and accompanying text.

would be minimal in most situations, but the benefits in terms of investor protection would prove great.

B. *Risk Capital Tests*

1. Arguments Asserted

A 1993 survey of state securities regulators indicated that some state securities agencies may have already taken the position, either formally or informally, that LLC interests may be investment contracts under a risk capital analysis.[336] A number of states[337] have adopted the risk capital test by case law,[338] statute,[339] or administrative ruling.[340] In some jurisdictions, the risk capital test is used as an alternative to the *Howey* test to determine what constitutes an "investment contract."[341] In other jurisdictions, the risk capital test serves as an independent means of defining a security.[342] There is no one formulation of the test.[343] There are many variations. Regardless of the version used, the risk capital test is considered broader in scope than the *Howey*

---

336. *See* Sargent Blue Sky, *supra* note 7, at 431.

337. The United States Supreme Court has not adopted the risk capital test. In United Hous. Found., Inc. v. Forman, 421 U.S. 837 (1975), the Court stated that "[e]ven if we were inclined to adopt . . . a 'risk capital' approach we would not apply it in the present case." *Id.* at 857 n.24. Also, the federal courts have not generally adopted the risk capital test. STEINBERG, *supra* note 135, § 2.02, at 24; *see, e.g.*, SEC v. Glenn W. Turner Enters., 474 F.2d 476, 483 & n.10 (9th Cir.) (refusing to apply risk capital test), *cert. denied*, 414 U.S. 821 (1973); *see also* Annotation, *"Risk Capital" Test for Determination of Whether Transaction Involves Security, Within Meaning of Federal Securities Act of 1933 (15 USCS §§ 77a et seq.) and Securities Exchange Act of 1934 (15 USCS §§ 78a et seq.)*, 68 A.L.R. FED. 89 (indicating the disagreements in the federal courts regarding the formulation of the risk capital test, its application, and its applicability) [hereinafter Annotation].

338. *See, e.g.*, Silver Hills Country Club v. Sobieski, 361 P.2d 906, 908-09 (Cal. 1961); Jaciewicki v. Gordarl Assocs., Inc., 209 S.E.2d 693, 695-97 (Ga. Ct. App. 1974); State v. Hawaii Mkt. Ctr., Inc., 485 P.2d 105, 109 (Haw. 1971); State v. George, 362 N.E.2d 1223, 1226-29 (Ohio Ct. App. 1975); State *ex rel.* Healy v. Consumer Business Sys., Inc., 482 P.2d 549, 552-54 (Or. Ct. App. 1971).

339. *See, e.g.*, ALASKA STAT. § 45.55.990(12) (1994); GA. CODE ANN. § 10-5-2(a)(26) (1994); MICH. COMP. LAWS ANN. § 451.801(l) (West Supp. 1995); N.D. CENT. CODE § 10-04-02(13) (Supp. 1993); OKLA. STAT. ANN. tit. 71, § 2(s)(16) (West 1995); WASH. REV. CODE ANN. § 21.20.005(12) (West 1989).

340. *See, e.g.*, ILL. ADMIN. CODE tit. 14, § 130.201(d) (Mar. 26, 1990), 1A Blue Sky L. Rep. (CCH) ¶ 22,614; Op. Cal. Att'y Gen. No. 66-284 (June 2, 1967), [1961-1971 Transfer Binder] Blue Sky L. Rep. (CCH) ¶ 70,747 (applying risk capital test to sale of a franchise); Okla. Sec. Comm'n Interpretive Op., 2A Blue Sky L. Rep. (CCH) ¶ 46,641 (July 3, 1980) (applying risk capital test to a franchise agreement).

341. *See, e.g.*, GA. CODE ANN. § 10-5-2(a)(26) (1994) ("The term 'investment contract' shall include but is not limited to an investment which holds out the possibility of return on risk capital . . . ."); *Healy*, 482 P.2d at 554 ("We hold that the *Howey* test is not exclusive and that the 'risk capital' test is also to be used in determining whether a particular financial activity constitutes an offer of an 'investment contract'. . . .").

342. A number of states define the term "security" to include, among other things, an investment contract and a form of the risk capital test. *See, e.g.*, ALASKA STAT. § 45.55.990(12) (1994); MICH. COMP. LAWS ANN. § 451.801(l) (West Supp. 1995); N.D. CENT. CODE § 10-04-02(13) (Supp. 1993); OKLA. STAT. ANN. tit. 71, § 2(s)(11), (16) (West 1995); WASH. REV. CODE ANN. § 21.20.005(12) (West 1989).

343. For example, compare the forms of the risk capital test *infra* notes 352, 354, 356.

test.[344] Application of the risk capital test often leads to finding a "security" where the *Howey* test would hold that no security is present.[345]

At least one state no-action letter[346] and four state administrative decisions[347] have cited the risk capital test as possible grounds for finding that an LLC interest is a security.[348] In states that have adopted the risk capital test, the test may prove particularly important when LLC interests may not be securities under the *Howey* test.[349] In such states, the risk capital test will usually provide prosecutors and plaintiffs with an alternative theory for arguing that certain LLC interests are securities.[350]

Justice Traynor of the California Supreme Court first articulated the risk capital theory in a 1961 opinion, *Silver Hills Country Club v. Sobieski*.[351] Simply stated, the opinion indicated that a "security" is present under the California Corporation Code when investors provide "risk capital" for a business.[352] The Hawaii Supreme Court applied and modified the risk capital theory in a 1971 opinion, *State v. Hawaii Market Center, Inc.*[353] The modified test required not only a finding of risk capital, but findings that the value given was induced by an offeror's representations of a valuable benefit, and

---

344. *See infra* notes 360-82 and accompanying text.

345. STEINBERG, *supra* note 135, § 2.02, at 24; *see also infra* notes 360-90 and accompanying text.

346. Exemption request—Membership interests in a limited liability company, 2A Blue Sky L. Rep. (CCH) ¶ 46,664 (Okla. Dep't of Sec.) (Aug. 28, 1992) (citing OKLA. STAT. ANN. tit. 71, § 2(s)(16) (Oklahoma's risk capital test)).

347. Georgia Express Action at 44-61, (No. 50-93-0075) (noting that, under Georgia law, the definition of a security includes both the *Howey* test and the "risk capital" test, but focusing primarily on the *Howey* test elements as applied in Georgia, and finding that the LLC interests constituted securities); Illinois Express Action at *11, 1993 WL 566300 (No. 9200106) (noting Illinois Administrative Code Rule 130.201(d) provides a broad risk capital test, but analyzing the facts and holding that the LLC interests were securities under the *Howey* test as applied in Illinois); *In re* Third Mobile Ltd. of Las Vegas, No. 94-03-0018, 1996 WL 28692 (Wash. Sec. Div.) (Jan. 18, 1996) (stating that the offer and/or sale of investments in the LLC constituted the offer and/or sale of "an investment contract and/or risk capital"); *In re* Dallas MobileComm L.C., No. 94-03-0018, 1995 WL 431589 (Wash. Sec. Div.) (July 10, 1995) (stating that the offer and/or sale of investments in the LLC constituted the offer and/or sale of "an investment contract and/or risk capital").

348. The authors of the no-action letter and two administrative decisions applied the *Howey* test and its progeny to determine whether the LLC interests constituted a security. Because the administrative hearing officers found the LLC interests in question to be securities under the *Howey* test, there was no reason to apply the broader risk capital test. However, by citing the risk capital test in each of these opinions, the authors are indicating that the risk capital test may be possible grounds for finding that an LLC interest is a security. *See supra* notes 346-47.

349. *See supra* notes 344-45, *infra* notes 360-90 and accompanying text.

350. *See supra* notes 341-42 and accompanying text.

351. 361 P.2d 906, 908-09 (Cal. 1961).

352. LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 203 (1988). In concluding a membership interest in a country club was a "security," the California Supreme Court stated:

> Since the [California Corporation Code] does not make profit to the supplier of capital the test of what is a security, it seems all the more clear that its objective is to afford those who risk their capital at least a fair chance of realizing their objectives in legitimate ventures whether or not they expect a return on their capital in one form or another.

Silver Hills, 361 P.2d at 908-09. The court's emphasis on the investor's advance of "risk capital" caused the theory to be referred to as the "risk capital" test.

353. 485 P.2d 105, 109 (Haw. 1971).

that the investor did not receive the right to exercise practical or actual control over the managerial decisions of the enterprise.[354]

Since 1971, a number of state courts and state legislatures have adopted various versions of the risk capital test.[355] The most common statutory formulation defines a "security" as an "investment of money or money's worth including goods furnished or services performed in the risk capital of a venture with the expectation of some benefit to the investor where the investor has no direct control over the investment or policy decision of the venture."[356]

---

354. The Hawaii Supreme Court's version of the risk capital test is based on the risk capital test suggested by Professor Ronald Coffey in his seminal article, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 W. RES. L. REV. 367, 377 (1967). In *Hawaii Market Center*, the Hawaii Supreme Court articulated its version of the risk capital test:

> [W]e hold that for the purposes of the Hawaii Uniform Securities Act (Modified) an investment contract is created whenever:
>
> (1) An offeree furnishes initial value to an offeror, and
>
> (2) a portion of this initial value is subjected to the risks of the enterprise, and
>
> (3) the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and
>
> (4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.

Hawaii Mkt. Ctr., 485 P.2d at 109 (footnote omitted).

355. There are a number of different versions of the risk capital test. For example, compare the California test set forth *supra* note 352, the Hawaiian test set forth *supra* note 354, and the other various formulations set forth in the cases cited at *supra* note 338. For an overview of state applications of the risk capital test see 12 LONG, *supra* note 84, § 2.04[3].

356. ALASKA STAT. § 45.55.990(12) (1994); *see also* N.D. CENT. CODE § 10-04-02(13) (1995) (differs only in that it provides "expectation of profit or some other form of benefit to the investor"); OKLA. STAT. ANN. tit. 71, § 2(s)(16) (West 1995) (differs only in that it provides goods furnished "and/or" services performed); WASH. REV. CODE ANN. § 21.20.005(12) (West 1989) (differs in that it provides an investment of money or "other consideration," the benefit must be a "valuable" benefit, and the investor "does not receive the right to exercise practical and actual control").

The Georgia and Michigan formulations of the risk capital test differ from the more common statutory version. Georgia defines the term "security" to include, among other things, an investment contract and provides further:

> The term "investment contract" shall include but is not limited to an investment which holds out the possibility of return on risk capital even though the investor's efforts are necessary to receive such return if:
>
> (A) Such return is dependant upon essential managerial or sales efforts of the issuer or its affiliates; and
>
> (B) One of the inducements to invest is the promise of promotional or sales efforts of the issuer or its affiliates in the investor's behalf; and
>
> (C) The investor shall thereby acquire the right to earn a commission or other compensation from sales of rights to sell goods, services, or other investment contracts of the issuer or its affiliates.

GA. CODE ANN. § 10-5-2(a)(26) (1994). Michigan defines the term "security" to include, among other things, an investment contract and:

> [A]ny contractual or quasi contractual arrangement pursuant to which: (1) a person furnishes capital, other than services, to an issuer; (2) a portion of that capital is subjected to the risks of the issuer's enterprise; (3) the furnishing of that capital is induced by the representations of an issuer, promoter, or their affiliates which give rise to a reasonable understanding that a valuable tangible benefit will accrue to the person furnishing the capital as a result of the operation of the enterprise; (4) the person furnishing the capital does not intend to be actively involved in the management of the enterprise in a meaningful way; and (5) a promoter or its affiliates anticipate at the time the capital is fur-

In essence, the risk capital tests are a refinement and an extension of the *Howey* investment contract test. Courts adopting the risk capital tests were seeking a more flexible approach to the definition of a security.[357] They were seeking a formulation that would recognize economic reality and reach the various schemes whereby promoters go to the public to solicit capital that will be risked in a business venture.[358] They hoped to protect the public by requiring registration so that promoters would disclose to potential investors that their investment would be at risk, and by providing remedies to investors if promoters failed to comply.[359]

The risk capital tests are expressly broader in scope than the *Howey* test.[360] First, the *Howey* test literally requires an investment of money.[361] Courts have loosely construed this requirement and found it to include investments of goods, services, and probably anything that constitutes legal consideration.[362] The risk capital tests differ from the *Howey* test in that they expressly require only a contribution of something of value.[363] Some tests even explicitly state nonmonetary contributions, such as goods and services, are sufficient.[364] So, the tests differ in that the risk capital tests often contain an expressly broader statement of the type of investment sufficient to meet the requirement.[365]

Second, the *Howey* test requires a court to find a "common enterprise."[366] Courts have interpreted "common enterprise" as requiring some pooling of interests or some form of profit-sharing, referred to as horizontal commonality or vertical commonality.[367] The risk capital tests do not use the phrase "common enterprise."[368] As a result, prosecutors and plaintiffs may

---

nished, that financial gain may be realized as a result thereof.
MICH. COMP. LAWS ANN. § 451.801(l) (West Supp. 1995)

357. *See, e.g.*, State *ex rel.* Healy v. Consumer Business Sys., Inc., 482 P.2d 549, 554 (Or. Ct. App. 1971).

358. *See, e.g.*, State v. Hawaii Mkt. Ctr., Inc., 485 P.2d 105, 109 (Haw. 1971); Silver Hills Country Club v. Sobieski, 361 P.2d 906, 908-09 (Cal. 1961).

359. *See, e.g.*, *Healy*, 482 P.2d at 554.

360. In SEC v. W.J. Howey Co., 328 U.S. 293 (1946), the United States Supreme Court stated, "an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person [1] invests his money [2] in a common enterprise and [3] is led to expect profits [4] solely from the efforts of the promoter or a third party . . . ." *Id.* at 298-99. For an extensive discussion of each of the elements of the *Howey* test, see *supra* part III.A.1.

361. *Howey*, 328 U.S. at 298-99.

362. *See supra* notes 124-28 and accompanying text.

363. *See, e.g.*, *Hawaii Mkt. Ctr.*, 485 P.2d at 109.

364. *See, e.g.*, ALASKA STAT. § 45.55.990(12) (1994).

365. At least two commentators maintain that the investment requirement in *Howey* and the investment requirement in the risk capital tests are essentially equivalent. 12 LONG, *supra* note 84, § 2.04[3], at 2-156; SARGENT HANDBOOK, *supra* note 1, § 4.01[2], at 4-8. While the *Howey* test and the risk capital tests may prove equivalent in application, the tests differ in that the applicability of the *Howey* test to ventures where the investment is in a form other than money depends on a court's continued broad construction of the *Howey* investment of money requirement. On the other hand, the applicability of the risk capital test to such a situation is dictated by the express terms of the test.

366. *Howey*, 328 U.S. at 298-99.

367. For a discussion of the *Howey* common enterprise requirement, see *supra* notes 134-40 and accompanying text.

368. *See, e.g.*, ALASKA STAT. § 45.55.990(12) (1994); *Hawaii Mkt. Ctr.*, 485 P.2d at 109.

argue there is no pooling of interest requirement or profit-sharing requirement.[369] So, the risk capital tests are broader than the *Howey* test in that a court may find an interest is a security even if there is no horizontal or vertical commonality, as long as the investor has transferred value to the seller.[370]

Third, the *Howey* test provides that the investor must expect "profits" from the investment.[371] The United States Supreme Court has interpreted this requirement as meaning the investor must be motivated to invest by an anticipated return on investment through either capital appreciation or earnings, not by a desire to use or consume the item purchased.[372] The risk capital tests are more liberal. They represent a departure from *Howey* in that they generally require only that investors be motivated by the expectation of a benefit.[373] The benefit can be monetary or nonmonetary, tangible or intangible.[374] The investor can even use or consume the anticipated benefit. For example, courts and state regulators have found club memberships, hotel reservations, and condominium time-share agreements to involve the sale of a security under risk capital tests.[375] The broader benefit concept means the risk capital tests apply to transactions that the *Howey* test may not cover due to the *Howey* test's more restrictive "profits" requirement.

Finally, the *Howey* test literally requires the investor to expect profits "solely from the efforts of the promoter or a third party."[376] Lower federal courts have rejected a literal interpretation of the word "solely" and simply require proof that the efforts made by those other than the investors are the undeniably significant efforts.[377] The risk capital tests, on the other hand, expressly adopt the more liberal version of the efforts of others requirement. The

---

369. Most commentators agree that under the risk capital tests there is no horizontal commonality requirement, and thus no requirement that multiple investors pool their interests. *See, e.g.*, THOMAS L. HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 1.5, at 42 (2d ed. 1990); SARGENT HANDBOOK, *supra* note 1, § 4.01[2], at 4-9; STEINBERG, *supra* note 135, § 2.02, at 24. Several commentators have also observed that there is no vertical commonality requirement, and therefore, no requirement that the promoter and investor share the profits or losses of the enterprise. HAZEN, *supra*; *see also* William J. Carney & Barbara G. Fraser, *Defining a "Security": Georgia's Struggle with the "Risk Capital" Test*, 30 EMORY L.J. 73, 111-13 (1981). *But see*, 12 LONG, *supra* note 84, § 2.04[3], at 2-156 (asserting that the concept of "risk capital of an enterprise" should be treated the same as the concept of the common enterprise in the *Howey* test).

370. Carney & Fraser, *supra* note 369, at 113.

371. *Howey*, 328 U.S. at 298-99.

372. United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852-58 (1975). For a discussion of the *Howey* expectation of profits requirement, see *supra* notes 145-51 and accompanying text.

373. *See, e.g.*, MICH. COMP. LAWS ANN. § 451.801(l) (West. Supp. 1995) ("a reasonable understanding that a valuable tangible benefit will accrue"); OKLA. STAT. ANN. tit. 71, § 2(s)(16) (West 1995) ("with the expectation of some benefit to the investor"); *Hawaii Mkt. Ctr.*, 485 P.2d at 109 ("a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue").

374. 12 LONG, *supra* note 84, § 2.04[3][a], at 2-156 to 2-157.

375. *Id.* at 2-157; *see, e.g.*, Silver Hills Country Club v. Sobieski, 361 P.2d 906, 908-09 (Cal. 1961) (memberships in country clubs); *In re* Alaska v. Vacation Int'l, Ltd., [1971-1978 Transfer Binder] Blue Sky L. Rep. (CCH) ¶ 71,294 (Alaska Sec. Div. 1976) (condominium time-share units); *see also* Nev. Op. Att'y Gen. No. 186 (Mar. 18, 1975), [1971-1978 Transfer Binder] Blue Sky L. Rep. (CCH) ¶ 71,200 (prepaid hotel accommodations).

376. *Howey*, 328 U.S. at 298-99.

377. *See, e.g.*, SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 482 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973). For a discussion of the *Howey* test's solely from the efforts of others requirement, see *supra* notes 158-63 and accompanying text.

risk capital tests do not utilize the qualifier "solely." They require that the investor either have no direct control or that the investor have no right to exercise practical or actual control.[378] Again, the risk capital tests are expressly broader than the *Howey* test and eliminate the need for courts to interpret the *Howey* "solely" from efforts of others requirement. The risk capital tests make it clear that the key to finding a security is the amount of practical or actual control the investor has over the managerial decisions of the venture.

To summarize, the risk capital tests generally are considered more expansive than the *Howey* investment contract test because: (1) nonmonetary investments are expressly recognized as sufficient;[379] (2) the "common enterprise" requirement is eliminated;[380] (3) the expectation of "profits" is not required, only the expectation of a benefit;[381] and (4) the efforts of others standard is expressly relaxed.[382]

Given that certain LLC interests can clearly qualify as securities under the *Howey* test,[383] there is an even greater probability that a court would characterize an LLC interest as a security under the risk capital theory. Investments in an LLC typically meet the first three elements of the risk capital tests. Under the risk capital tests, an investor must risk money, property, or services in a venture with the expectation of some benefit.[384] An investment in an LLC normally involves contributing money, property, or services,[385] and it is unlikely an investment in an LLC venture would be risk free. As one commentator noted, LLC investments usually are not collateralized, nor do promoters generally provide fixed rates of return, a guarantee, or priority over creditors.[386] Also, in most situations, an investor contributes to an LLC expecting some form of benefit in return.[387] Like the *Howey* test, the key issue often will be whether the investor exercises practical or actual control over the managerial decisions of the enterprise.[388] However, given the risk capital theory's focus on economic reality and investor protection,[389] courts are likely to construe the control element more liberally under the risk capital tests than under *Howey*. Due to its broader application and the more liberal con-

---

378. *See, e.g.*, MICH. COMP. LAWS ANN. § 451.801(l) (West Supp. 1995) ("the person furnishing the capital does not intend to be actively involved in the management of the enterprise in a meaningful way"); N.D. CENT. CODE § 10-04-02(13) (1995) ("the investor has no direct control over the investment or policy decisions of the venture"); *Hawaii Mkt. Ctr.*, 485 P.2d at 109 ("the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise").

379. *See supra* notes 361-65 and accompanying text.

380. *See supra* notes 366-70 and accompanying text.

381. *See supra* notes 371-75 and accompanying text.

382. *See supra* notes 376-78 and accompanying text.

383. *See supra* part III.A.1.

384. *See* STEINBERG, *supra* note 135, at 257; *see also* ALASKA STAT. § 45.55.990(12) (1994); *Hawaii Mkt. Ctr.*, 485 P.2d at 109.

385. *See supra* notes 129-33 and accompanying text.

386. SARGENT HANDBOOK, *supra* note 1, § 4.02[2], at 4-14.

387. *See supra* notes 152-57 and accompanying text.

388. *See* SARGENT HANDBOOK, *supra* note 1, § 4.02[2], at 4-14; *see also* ALASKA STAT. § 45.55.990(12) (1994); *Hawaii Mkt. Ctr.*, 485 P.2d at 109.

389. *See supra* notes 357-59 and accompanying text.

struction, there is an even better chance that courts will characterize LLC interests as securities under the risk capital theory.[390]

2. Possible Defenses

Some commentators contend that the risk capital test is not substantially different than the *Howey* test.[391] First, some commentators argue the investment element under the risk capital tests is basically equivalent to courts' liberal construction of the *Howey* investment of money requirement.[392] Second, although the risk capital tests do not use the phrase "common enterprise," the investment must be risked in some sort of venture.[393] At least one commentator has argued that the venture or enterprise requirement under the risk capital tests is essentially the same as the *Howey* common enterprise requirement.[394] Third, even though the expectation of a benefit element under the risk capital tests is broader than the expectation of profits element under *Howey*,[395] the benefits element only impacts the few extraordinary situations where investors do not expect profits in the narrow sense.[396] Finally, to the extent the risk capital tests require that the investor have no direct control over the investment or policy decisions of the venture,[397] some commentators claim the risk capital tests are simply adopting the liberal construction of the case law interpreting the phrase "efforts of others" that has developed under *Howey*.[398] Consequently, application of the broader risk capital tests might affect a few marginal cases, but essentially the issues and the analysis are the same.[399] Therefore, there should be no greater chance of LLC interests being characterized as securities in risk capital jurisdictions than under the *Howey* test.[400]

Very few jurisdictions have adopted the risk capital test to determine the existence of a security.[401] Critics of the risk capital test charge that the test is plagued by limited acceptance, lack of uniformity in its application, and uncertainty about its meaning.[402] For example, the exact meaning of the key term "risk capital" still remains unclear.[403] Does the risk capital test apply when-

390. *See* STEINBERG, *supra* note 135, § 2.02, at 24.

391. *See, e.g.*, SARGENT HANDBOOK, *supra* note 1, § 4.01[2], at 4-8.

392. *Id.*; *see also* 12 LONG, *supra* note 84, § 2.04[3], at 2-156.

393. *See, e.g.*, OKLA. STAT. ANN. tit. 71, § 2(s)(16) (West 1995) ("investment . . . in the risk capital of a venture"); *Hawaii Mkt. Ctr.*, 485 P.2d at 109 ("a portion of this initial value is subjected to the risks of the enterprise").

394. 12 LONG, *supra* note 84, § 2.04[3], at 2-156 ("The concept of an enterprise under the risk capital test will be essentially the same as the concept of common enterprise as outlined under the *Howey* test.").

395. *See supra* notes 371-75 and accompanying text.

396. SARGENT HANDBOOK, *supra* note 1, § 4.01[2], at 4-9.

397. *See, e.g.*, N.D. CENT. CODE § 10-04-02(13) (1995); *Hawaii Mkt. Ctr.*, 485 P.2d at 109.

398. 12 LONG, *supra* note 84, § 2.04[4], at 2-166; SARGENT HANDBOOK, *supra* note 1, § 4.01[2], at 4-8.

399. SARGENT HANDBOOK, *supra* note 1, § 4.02[2], at 4-14.

400. *Id.*

401. See *supra* notes 338-40 and accompanying text indicating adoption of the risk capital test in only eleven states. Also, the risk capital test generally is not adopted by the federal courts. *See supra* note 337.

402. *See, e.g.*, SARGENT HANDBOOK, *supra* note 1, § 4.01[2], at 4-7 to 4-8.

403. 12 LONG, *supra* note 84, § 2.04[3], at 2-155 to 2-156; SARGENT HANDBOOK, *supra* note

ever a person invests capital with less than a fair chance of receiving a return or does the test only apply when capital is invested in a highly risky or unstable venture?[404] Does the test only apply when a venture is seeking its initial capitalization[405] or does the test apply when an on-going concern is seeking additional capital?[406] Decisions are split on the answers to these questions.[407] There is no universal understanding as to the tests' application. LLC promoters therefore may argue that given the ambiguity created by the risk capital tests, the relative lack of case law, and the fact that the tests are merely a refinement of the *Howey* test, courts should be guided by the *Howey* line of cases. Specifically, courts should draw on the *Howey* general partnership cases to interpret the control element and adopt a strong presumption against characterizing LLC interests as securities.[408] LLC promoters may contend that courts have no basis for adopting a more liberal interpretation of the control element under the risk capital tests than under the *Howey* test.[409] Further, on theoretical grounds, a strong presumption that LLC interests are not securities would provide a clear and predictable rule, reduce litigation, and decrease associated legal compliance costs.[410]

3. Conclusions

Clearly, certain LLC interests may be securities under a risk capital analysis.[411] In states that have adopted risk capital tests,[412] the tests will usually provide prosecutors and plaintiffs with an alternative theory for arguing certain LLC interests are securities.[413] While the risk capital tests focus

---

1, § 4.01[2], at 4-9; Louis C. Novak & Howard Rosten, Note, *Franchise Regulation Under the California Corporate Securities Law*, 5 SAN DIEGO L. REV. 140, 152-55 (1968).

404. Novak & Rosten, *supra* note 403, at 152-55. *Compare* Silver Hills Country Club v. Sobieski, 361 P.2d 906, 908-09 (Cal. 1961) (stating that the objective of the risk capital test is "to afford those who risk their capital at least a fair chance of realizing their objectives") *with* Mr. Steak, Inc. v. River City Steak, Inc., 324 F. Supp. 640, 647 (D. Colo. 1970) (arguing that the better view is to limit the applicability of the risk capital test to exceptionally high risk, speculative ventures), *aff'd*, 460 F.2d 666 (10th Cir. 1972). For other cases interpreting the risk requirement, see Annotation, *supra* note 337, § 3[a].

405. *See, e.g.*, State *ex rel.* Healy v. Consumer Business Sys., Inc., 482 P.2d 549, 555 (Or. Ct. App. 1971) ("Under the 'risk capital' test we are concerned with whether the franchisor is dependent upon the franchisees' capital to initiate his operations, not just manufacture his product.").

406. *See, e.g.*, State *ex rel.* Park v. Glenn Turner Enters., Inc., [1971-1978 Transfer Binder] Blue Sky L. Rep. (CCH) ¶ 71,023 (Idaho Dist. 1972).

407. *See supra* notes 404-06 and accompanying text.

408. For a discussion of the *Howey* line of cases dealing with general partnership interests and related presumptions see *supra* notes 240-54 and accompanying text.

409. LLC promoters may argue that the language in some risk capital tests is even more restrictive than the more liberal control test adopted by most courts under *Howey*. *Compare* WASH. REV. CODE ANN. § 21.20.005(12) (West 1989) (stating that "the investor does not receive the right to exercise practical or actual control over the managerial decisions of the venture") *with* SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 482 (9th Cir.) (requiring proof that "the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise"), *cert. denied*, 414 U.S. 821 (1973).

410. For a discussion of the arguments that on theoretical grounds there should be a strong presumption that LLC interests are not securities, see *supra* notes 264-71 and accompanying text.

411. *See supra* notes 384-88 and accompanying text.

412. *See supra* notes 338-40 and accompanying text.

413. *See supra* notes 341-42 and accompanying text.

on some of the same criteria as the *Howey* test, they are explicitly broader in scope.[414] The risk capital tests expressly apply to transactions that the *Howey* test does not reach.[415] The risk capital tests also eliminate the need for liberal judicial construction, which is often required to find that a security is present under the *Howey* test.[416] As a result, application of the risk capital tests may lead to finding an LLC interest is a security, where the *Howey* test would hold no security is present.

In most cases, an investment in an LLC will satisfy the first three elements of the risk capital tests.[417] Most LLC investors risk money, property, or services in an LLC venture, expecting a benefit in return. Like *Howey*, the critical issue will be whether the investor exercises practical or actual control over the managerial decisions of the enterprise.[418] Since there is lack of uniformity and some ambiguity in applying the risk capital tests,[419] courts have the opportunity to refine and develop the definition of a security under these tests. In applying the risk capital tests to LLCs, courts are not required to follow the general partnership case law that evolved under *Howey* nor adopt the associated presumptions. Courts are free to construe the risk capital tests liberally and adopt flexible constructions designed to protect investors against fraud and clever new schemes devised by promoters to evade the securities laws.

C. *Characteristics of Stock Test*

1. Arguments Asserted

Commentators[420] and at least two state securities commissions[421] have asserted that certain LLC interests may be securities under the characteristics of stock test set forth in *Landreth Timber Co. v. Landreth*.[422] In *Landreth*, the United States Supreme Court held that if an instrument bears the label

---

414. *See supra* notes 360-82 and accompanying text.
415. *See supra* notes 361-82 and accompanying text.
416. *See supra* notes 362-65, 371-78 and accompanying text.
417. *See supra* notes 384-87 and accompanying text.
418. *See supra* notes 388, 397-98 and accompanying text.
419. *See supra* notes 402-07 and accompanying text.
420. Steinberg Article, *supra* note 7, at 1116; *see also* Peralta, *supra* note 7, at 36-40.
421. Limited liability company interests as securities, 2A Blue Sky L. Rep. (CCH) ¶ 54,521 (Tenn. Mar. 7, 1995) (stating that if an LLC interest possesses the characteristics of stock set forth in *Landreth*, it is the Tennessee Division of Securities' position that the interest is a security) [hereinafter Tennessee Statement of Policy]; *see* Georgia Express Action at 46, (No. 50-93-0075) (stating that the Georgia Commissioner of Securities urged the referee to apply the test traditionally used to determine whether a particular investment constitutes stock to determine whether an LLC interest is a security). Also, in a request for an interpretive opinion from the Maryland Securities Division, an LLC issuer argued that the LLC interests at issue were not securities because, among other things, the interests bore no resemblance to stock as characterized by the *Tcherepnin*, *Landreth*, and *Forman* Courts. Exemption request—Whether membership interests in a limited liability company are required to be registered, 2 Blue Sky L. Rep. (CCH) ¶ 30,579 (Md. Sec. Comm'r) (Apr. 25, 1994). The Maryland Securities Division stated that it would take no action to require the registration of the LLC interests in question, but the Division did not state the grounds for its decision. *Id.*
422. 471 U.S. 681 (1985). The SEC did not raise this argument in *Vision Communications*, *Parkersburg*, or *Knoxville*.

"stock" and possesses all the characteristics typically associated with stock, the securities laws apply.[423] The Court did note, however, that the instrument's label is not determinative.[424] The key inquiry is whether the instrument bears the attributes usually associated with stock, meaning: (i) the right to receive dividends upon an apportionment of profits; (ii) negotiability; (iii) the ability to be pledged; (iv) voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value.[425]

Professor Marc Steinberg maintains that LLC interests ordinarily possess the five attributes commonly associated with stock.[426] First, since LLC statutes generally provide for the distribution of profits to members based on capital contribution,[427] owners of an LLC often have the right to receive dividends upon the apportionment of profits. Second, LLC statutes allow members to transfer or assign their LLC interests, therefore LLC interests are negotiable.[428] Third, an LLC interest is personal property and as such may be pledged.[429] Fourth, most LLC statutes vest management in the members, unless the LLC operating documents provide otherwise.[430] Voting rights are usually determined in proportion to the member's capital contribution, so members have voting rights.[431] Fifth, LLC interests may increase in value.[432] Professor Steinberg and other commentators have argued that because "companies" issue LLC interests and companies typically issue stock to evidence an equity interest, investors expect such interests to be governed by the securities laws.[433] They assert substance should prevail over form and labels.[434] If LLC interests possess the five attributes usually associated with stock, such interests should be deemed securities.[435]

At least one state securities commission has taken the position that LLC interests may be securities under the characteristics of stock test set forth in *Landreth*. In a Statement of Policy, the Tennessee Division of Securities stated

---

423. *Landreth*, 471 U.S. at 686; *see also* Gould v. Ruefenacht, 471 U.S. 701, 704 (1985) (applying the standard from *Landreth*).

424. *Landreth*, 471 U.S. at 686; *see also* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 848-51 (1975) (stating that the emphasis should be on "economic reality").

425. *Landreth*, 471 U.S. at 686; *see also Gould*, 471 U.S. at 704; *Forman*, 421 U.S. at 851.

426. Steinberg Article, *supra* note 7, at 1119; *see also* Peralta, *supra* note 7, at 37-39.

427. Steinberg Article, *supra* note 7, at 1116-17; *see also* 1 RIBSTEIN & KEATINGE, *supra* note 1, § 5.02, at 5-2 (stating that financial rights in LLCs are generally based on members' capital contributions).

428. Steinberg Article, *supra* note 7, at 1117-19; *see also* 1 RIBSTEIN & KEATINGE, *supra* note 1, § 7.04, at 7-4 (stating that LLC statutes provide for transfer and assignment of membership interests).

429. Steinberg Article, *supra* note 7, at 1119; *see also* Donn, *supra* note 1, § 12, at PGLLC-40 (stating that the general rule in all the state LLC acts is that an LLC interest is personal property).

430. Steinberg Article, *supra* note 7, at 1117; *see also* Donn, *supra* note 1, § 10, at PGLLC-36 (stating that generally management is vested in the members).

431. Steinberg Article, *supra* note 7, at 1117; *see also* 1 RIBSTEIN & KEATINGE, *supra* note 1, § 8.03, at 8-8.

432. Steinberg Article, *supra* note 7, at 1119.

433. Steinberg Article, *supra* note 7, at 1116; *see also* Peralta, *supra* note 7, at 31-33, 36-40 (on their face LLCs appear to be nothing more than traditional corporations with a different set of descriptive terms).

434. Steinberg Article, *supra* note 7, at 1116; *see also* Peralta, *supra* note 7, at 31-33, 36-40.

435. Steinberg Article, *supra* note 7, at 1116; *see also* Peralta, *supra* note 7, at 31-33, 36-40.

that it believes LLC interests should be analyzed under *Landreth*.[436] The Division takes the position that if an LLC interest possesses the five attributes usually associated with stock, the LLC interests could be labeled "stock" which is a security under Tennessee law.[437] If an LLC interest possesses the five attributes usually associated with stock, prosecutors and plaintiffs may argue, citing *Landreth* and the authorities and arguments outlined above, such LLC interests should be deemed securities.

2. Possible Defenses

The Kansas Securities Commissioner and a trier of fact in an administrative hearing in Georgia considered, but ultimately rejected, the argument that LLC interests should be considered securities because they possess the characteristics of stock.[438] "Stock" is one of the many financial instruments listed expressly in the statutory definitions of a "security."[439] Commentators argue that each statutory term is susceptible to separate analysis, based on separate analytical concepts.[440] In *Landreth*, the United States Supreme Court made it clear that stock may be viewed as being in a category by itself for purposes of interpreting the scope of the definition of a security.[441]

In *Landreth*, as in the other United States Supreme Court decisions dealing with the characteristics of stock test, the interest the Court considered was labeled "stock."[442] LLCs do not issue "stock,"[443] and LLC statutes do not refer to LLC interests as "stock."[444] Also, commentators and others do not refer to LLC interests as "stock."[445] The issue therefore becomes whether an instrument not labeled "stock" could constitute a security under the separate test the Court devised for "stock."[446] LLC issuers may argue that *Landreth* and the related cases apply only to instruments that are labeled "stock." Nowhere, in either *Landreth* or the other United States Supreme Court decisions, did the Court indicate that any instrument that possessed the characteristics of stock constituted a security.[447]

---

436. Tennessee Statement of Policy, *supra* note 421.

437. *Id.*

438. Interpretive Opinion Orchards Drug, L.C., 1991 WL 101804, at *3 (Kan. Sec. Comm'r) (May 1, 1991); Georgia Express Action at 46, (No. 50-93-0075).

439. *See* Securities Act of 1933 § 2(l), 15 U.S.C. § 77b(1) (1994); Securities Exchange Act of 1934 § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1994); UNIF. SEC. ACT § 401(l) (1958), 7B U.L.A. 580-81 (1985); UNIF. SEC. ACT § 101(16) (1988), 7B U.L.A. 94 (Supp. 1995).

440. 2 LOSS & SELIGMAN, *supra* note 99, at 871.

441. Landreth Timber Co. v. Landreth, 471 U.S. 681, 694 (1985).

442. *See id.* at 683; Gould v. Ruefenacht, 471 U.S. 701, 702 (1985); United Hous. Found., Inc. v. Forman, 421 U.S. 837, 848 (1975).

443. Sargent Article, *supra* note 7, at 1095; Steinberg Article, *supra* note 7, at 1116.

444. *See, e.g.*, Donn, *supra* note 1, § 1, at PGLLC-6 to -7; *see generally* state limited liability company statutes, *supra* note 4.

445. *See generally supra* note 1 (commentaries on limited liability companies).

446. *See* Interpretive Opinion Orchards Drug L.C., 1991 WL 101804, at *3 (Kan. Sec. Comm'r) (May 1, 1991); *see also* Peralta, *supra* note 7, at 36.

447. Ribstein, *supra* note 7, at 832-33; *see, e.g.*, Gould v. Ruefenacht, 471 U.S. 701 (1985); Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985); United Hous. Found., Inc. v. Forman, 421 U.S. 837, 848 (1975). *But see* Peralta, *supra* note 7, at 36-37 (citing United States Supreme Court authority and arguing that for an investment to constitute a security as "stock," the word "stock" itself need not be used).

Professor Steinberg maintains that the characteristics of stock test should be applied to LLC interests because "companies" issue such interests and investors expect such interests to be governed by the securities law.[448] Critics assert that the statutory definition of a security does not contain the term "company."[449] Further, entities that might be thought of by investors as "companies" issue most, if not all, financial instruments. The logical extension of Professor Steinberg's theory would result in applying the characteristics of stock test to all instruments issued by "companies." Applying the characteristics of stock test to all instruments in the statutory definition of a "security" that are issued by companies would make the definition's enumeration of the various types of instruments superfluous.[450] The Supreme Court has also made it clear that there is no universal or generic test for what constitutes a security.[451] Nevertheless, taking Professor Steinberg's argument to its logical conclusion would result in a generic test applied to all interests issued by "companies."

Furthermore, many business people use the term "company" loosely to refer to partnerships and other joint ventures.[452] If the characteristics of stock test were applied to all such ventures, including general partnerships, most or at least many of the elements of the characteristics of stock test would be met.[453] Such a result is not consistent with prior precedent holding that certain general partnership and joint venture interests are not securities.[454] Some commentators charge that investors do not expect LLC interests to be "stock" merely because limited liability companies have the term "company" in their title,[455] thus allowing LLC issuers to argue that investors do not necessarily expect LLC interests to be covered by the securities laws.[456]

Professor Larry Ribstein asserts that, even if the *Landreth* test applies, LLC interests do not meet the characteristics of stock test.[457] Professor

---

448. Steinberg Article, *supra* note 7, at 1116.

449. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-5; *see also supra* notes 98-99 (statutory definitions of a security).

450. *Cf. Landreth*, 471 U.S. at 692 (applying the *Howey* investment contract test to all instruments would make the statutory enumeration superfluous).

451. 2 LOSS & SELIGMAN, *supra* note 99, at 871 & n.5; *see also Landreth*, 471 U.S. at 691-92.

452. *See, e.g.*, Ribstein, *supra* note 7, at 833.

453. *See* Interpretive Opinion Orchards Drug L.C., 1991 WL 101804, at *3 (Kan. Sec. Comm'r) (May 1, 1991).

454. Generally, courts do not treat a general partnership interest as a security, unless the general partner is expected to be a passive investor who will not participate in the management of the business. Schneider, *supra* note 134, at 138; *see, e.g.*, Banghart v. Hollywood Gen. Partnership, 902 F.2d 805, 807-08 (10th Cir. 1990); Goodwin v. Elkins & Co., 730 F.2d 99, 102-03 (3d Cir.), *cert. denied*, 469 U.S. 831 (1984); Williamson v. Tucker, 645 F.2d 404, 424-25 (5th Cir.), *cert. denied*, 454 U.S. 897 (1981). Joint ventures are subject to the same analysis as partnership interests. 2 LOSS & SELIGMAN, *supra* note 99, at 956 n.200 (citing numerous authorities). The United States Supreme Court has not considered whether interests in general partnerships or joint ventures constitute securities.

455. Ribstein, *supra* note 7, at 833.

456. *See id.*; *see also* Georgia Express Action at 46, (No. 50-93-0075) (LLC interests do not appear on their face to be what is commonly known as traditional "stock"); *infra* discussion part III.D (explaining arguments and defenses regarding instruments commonly known as securities).

457. Ribstein, *supra* note 7, at 833; *see also* Goforth, *supra* note 7, at 1242-47 (arguing LLC interests are no more akin to stock than general partnership interests, which have not been found

Ribstein maintains that LLC statutes do not generally provide for dividend rights, they invariably restrict transferability of management rights, and they allow allocation of voting rights per capita rather than pro rata.[458] Based on the arguments and authorities discussed in this section, LLC issuers have a strong argument that LLC interests should not be deemed securities under the *Landreth* characteristics of stock test.

3. Conclusions

Professor Steinberg's argument that LLC interests should be analyzed as stock because companies issue the interests[459] is a novel approach. Nevertheless, there appears to be no authority to support the application of the characteristics of stock test to instruments other than those labeled "stock."[460] The argument is also at odds with the Supreme Court's statement that stock should be viewed as being in a category by itself.[461] Moreover, the logical extension of this argument would lead to results inconsistent with prior precedent.[462]

Commentators have criticized the characteristics of stock test on theoretical grounds. Commentators argue the formalistic five-factor *Landreth* test elevates form over substance,[463] therefore conflicting with many United States Supreme Court decisions stating that form should be disregarded for substance and emphasis placed upon economic reality.[464] *Landreth* is viewed as an anomaly. Some argue that *Landreth's* precedential value is limited since it represents a situation where the Court ignored traditional considerations because it was unwilling to rule that common stock was not a security.[465] In light of such criticism, there is little reason to broaden the test's application beyond its narrow purpose to determine whether stock is a security.

From a practical standpoint, if a court applies the characteristics of stock test to determine whether an LLC interest is a security, the determination would depend on whether the LLC interest satisfies the *Landreth* five-factor test. Professor Steinberg maintains that LLC interests ordinarily satisfy the test.[466] Professor Ribstein, on the other hand, asserts that LLC interests normally do not meet the test.[467] Given that LLC statutes provide members the flexibility to tailor the characteristics of the entity,[468] application of the

---

to possess the characteristics of stock).

458. Ribstein, *supra* note 7, at 833; *see also* Goforth, *supra* note 7, at 1242-47.

459. *See supra* notes 433-35 and accompanying text.

460. *See supra* note 447 and accompanying text.

461. *See supra* note 441 and accompanying text.

462. *See supra* notes 450-54 and accompanying text.

463. *See, e.g.*, Lewis D. Lowenfels & Alan R. Bromberg, *What Is a Security Under the Federal Securities Laws?*, 56 ALB. L. REV. 473, 559 (1993).

464. *Id.*; *see, e.g.*, International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 558 (1979); United Hous. Found., Inc. v. Forman, 421 U.S. 837, 851-52 (1975); Tcherepnin v. Knight, 389 U.S. 332, 336 (1967).

465. *See, e.g.*, Lowenfels & Bromberg, *supra* note 463, at 559-60.

466. *See supra* notes 426-32 and accompanying text.

467. *See supra* notes 457-58 and accompanying text.

468. Sargent Article, *supra* note 7, at 1073-77. For example, LLC distribution provisions, transfer restrictions, and voting rights allocations may vary depending upon the state of formation or the provisions in the articles of organization or the operating agreement. *See* 1 RIBSTEIN &

Landreth test to LLC interests would result in a case-by-case analysis. A court would need to review an LLC's operating agreement and articles of organization to determine whether the LLC interest satisfies the test.[469]

Not only would use of the characteristics of stock test lead to litigation, but more importantly, it would result in carefully drafted LLC documents designed to escape the reach of the securities laws by insuring that one of the elements in the five-factor test is not met. Application of the *Landreth* test to LLCs would create an environment where formalistic devices could become determinative due to the way the test is structured. Moreover, if an LLC interest did not satisfy the elements of the *Landreth* test, nothing would preclude a court from applying the investment contract test.[470] As such, application of the *Landreth* test to LLC interests does not appear to be a satisfactory solution from either a theoretical or practical standpoint.

D. *Commonly Known as a Security*

1. Arguments Asserted

The federal securities acts and most state securities acts define the term "security" to include any "instrument commonly known as a 'security.'"[471] At least one commentator has argued that an interest in an LLC constitutes an interest or instrument "commonly known as a 'security.'"[472] The phrase "commonly known as a 'security'" has not generated much litigation[473] and neither the United States Supreme Court nor other federal courts have provided much guidance on how to interpret the phrase.[474] Professor Marc

---

KEATINGE, *supra* note 1, § 6.02, at 6-2 (distribution provisions may be customized), § 7.04, at 7-4 to 7-5 (some LLC statutes permit variation of transferability restrictions by contrary provisions in the articles of organization or operating agreement), and § 8.03, at 8-8 (most states allocate voting rights according to capital contribution, but several states allocate voting rights per capita).

469. *See* Steinberg Article, *supra* note 7, at 1119.

470. *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 851-58 (1975) (concluding that the interest did not satisfy the characteristics of stock test, the Court then considered whether the interest constituted an investment contract).

471. Securities Act of 1933 § 2(l), 15 U.S.C. § 77b(1) (1994); Securities Exchange Act of 1934 § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1994); UNIF. SEC. ACT § 401(l) (1958), 7B U.L.A. 580-81 (1985); UNIF. SEC. ACT § 101(16) (1988), 7B U.L.A. 94 (Supp. 1995). The Securities Act and Uniform Securities Acts list any interest or instrument commonly known as a security, while the Exchange Act lists only any instrument commonly known as a security. However, this distinction appears to have little practical effect due to the expansiveness of other terms in the Exchange Act. ARNOLD S. JACOBS, 5B LITIGATION AND PRACTICE UNDER RULE 10b-5, § 38.03[a][i], at 2-155 to 2-156 (1994).

472. Steinberg Article, *supra* note 7, at 1120-22 (arguing that one can classify an LLC interest as "any interest or instrument commonly known as a security"). The SEC did not make this argument in its complaints or memorandums to the court in *Vision Communications, Parkersburg*, or *Knoxville*. The triers of fact in the state actions summarized and cited *infra* Table I did not expressly address this argument either.

473. 2 LOSS & SELIGMAN, *supra* note 99, at 209 (Supp. 1994); Geu, Part Two, *supra* note 1, at 514.

474. *See* Tcherepnin v. Knight, 389 U.S. 332, 343-44 (1967) (criticizing court of appeal's conclusion that withdrawable capital shares were not an instrument commonly known as a security); 5B JACOBS, *supra* note 471, § 38.03[q] (discussing how to determine whether an instrument is "commonly known" as a security)

Steinberg suggests[475] that to determine what interests or instruments are commonly known as securities, courts should: (i) examine the expectations or perceptions of the investing public, or, alternatively; (ii) apply the family resemblance test set forth in *Reves v. Ernst & Young*.[476]

a. *Public's Expectations*

Alluding to the phrase any instrument "commonly known as a 'security,'" the United States Supreme Court stated, "Congress intended the securities laws to cover those instruments ordinarily and commonly considered to be securities in the commercial world . . . ."[477] In *Forman*,[478] *Landreth*,[479] and *Reves*,[480] the Court indicated the investing public's expectations or perceptions are relevant in determining whether an instrument is a security.[481] Commentators argue that an investor purchasing an LLC interest would reasonably expect the transaction to be governed by the securities laws.[482] Investors are purchasing an equity interest in a "company" and such transactions are typically subject to the securities laws.[483] Additionally, LLC interests generally possess the characteristics associated with securities such as stock.[484] Thus, a reasonable investor would be justified in assuming the securities laws apply,[485] especially since nothing indicates that the securities laws do not apply. Courts, therefore, should deem an LLC interest to be an interest "commonly known as a 'security,'" considering the public's expectation.[486]

---

475. *See* Steinberg Article, *supra* note 7, at 1120-22.

476. 494 U.S. 56 (1990).

477. Marine Bank v. Weaver, 455 U.S. 551, 559 (1982).

478. United Hous. Found., Inc. v. Forman, 421 U.S. 837 (1975). In *Forman*, there is dicta stating that the name given to an instrument might reasonably lead an investor to believe the federal securities laws apply. The Court noted that the use of traditional names such as "stocks" or "bonds" will lead the purchaser to justifiably assume the securities laws apply. *Id.* at 850. But, the Court held that although the instrument was called "stock," it had none of the characteristics of stock. The purchaser, therefore, could have no reasonable expectation that his transaction was covered by the securities law. *Id.* at 851.

479. Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985). In *Landreth*, the Court held that because the instrument was called "stock" and bore the usual characteristics of stock, the purchaser was justified in assuming the federal securities laws governed the purchase. *Id.* at 687. The Court, relying on public expectations, held common stock is a security. *Id.* at 687, 694.

480. Reves v. Ernst & Young, 494 U.S. 56 (1990). In *Reves*, the Court stated that in deciding whether a transaction involves a "security" it will examine the "reasonable expectations of the investing public." *Id.* at 66. The Court said it "will consider instruments to be 'securities' on the basis of such public expectations." *Id.*

481. *See* Lowenfels & Bromberg, *supra* note 463, at 555-57; Steinberg Article, *supra* note 7, at 1120; *supra* notes 478-80.

482. Steinberg Article, *supra* note 7, at 1116, 1120; *see* Peralta, *supra* note 7, at 31.

483. Steinberg Article, *supra* note 7, at 1116, 1120; *see also* Peralta, *supra* note 7, at 31-33, 36-40; *supra* note 433 and accompanying text.

484. Steinberg Article, *supra* note 7, at 1116-19; *see also* Peralta, *supra* note 7, at 31-33, 36-40; *supra* notes 426-32 and accompanying text.

485. Steinberg Article, *supra* note 7, at 1116, 1120; *see* Peralta, *supra* note 7, at 31-33.

486. *Cf.* Reves v. Ernst & Young, 494 U.S. 56, 66-67 (1990).

b. *Family Resemblance Test*

One can also argue an LLC interest is a security under the family resemblance test set forth in *Reves*.[487] In *Reves*, the United States Supreme Court analyzed when a "note" is a security.[488] The Court stated that in deciding whether a transaction involves a security, the Court examines four factors: (i) the motivations of the buyer and seller; (ii) the plan of distribution; (iii) the reasonable expectations of the investing public; and (iv) the presence of other risk-reducing factors.[489] The Court uses these four factors to identify those instruments that bear a strong "family resemblance" to items previously identified as securities.[490] If, based on these factors, an LLC interest bears a strong "family resemblance" to other items previously identified as securities, at least one commentator has argued courts should deem such LLC interests securities.

In discussing the first factor, motivations, the Court stated that if the seller's purpose is to raise money for general business operations or to finance a substantial investment and if the buyer is interested primarily in profit, the instrument is likely to be a security.[491] Often LLC interests are sold to raise seed capital for a venture. Also, LLC investors ordinarily expect a return on their investment from capital appreciation, earnings, or tax benefits.[492] Applying this analysis, the sale of an LLC interest is likely to meet the first test.

With respect to the second factor, plan of distribution, the Court stated that if there is common trading for speculation or investment, the instrument is more likely to be a security.[493] Based on the Court's application of this factor in *Reves*, the test apparently is satisfied if the instrument is offered to the general public, even if no secondary trading market exists.[494] As a result, if an LLC interest is offered to the general public, even if there were few offerees or purchasers, this element apparently is satisfied.[495]

The Court noted in discussing the third factor, public expectations, that it will consider instruments to be securities based on the reasonable expectations or perceptions of the investing public.[496] As discussed previously, investors may be justified in expecting the securities laws to apply to the purchase and sale of LLC interests.[497] Therefore, the public expectation requirement may be met.

---

487. *Id.* at 65-67. For additional commentary on *Reves*, see James D. Gordon III, *Interplanetary Intelligence About Promissory Notes as Securities*, 69 TEX. L. REV. 383 (1990); Janet Kerr & Karen M. Eisenhauser, Reves *Revisited*, 19 PEPP. L. REV. 1123 (1992); Marc I. Steinberg, *Notes as Securities:* Reves *and Its Implications*, 51 OHIO ST. L.J. 675 (1990).

488. *Reves*, 494 U.S. at 60-73.

489. *Id.* at 66-67.

490. *Id.* at 65-67.

491. *Id.* at 66.

492. Steinberg Article, *supra* note 7, at 1121 & n.100.

493. *Reves*, 494 U.S. at 66.

494. *See id.* at 68; *see also* Schneider, *supra* note 134, at 130.

495. Steinberg Article, *supra* note 7, at 1121 & nn.101-02.

496. *Reves*, 494 U.S. at 66-67.

497. *See supra* notes 482-86 and accompanying text; *see also supra* text accompanying note 433.

Finally, the Court noted that the existence of another regulatory scheme reducing the investor's risk would make the application of the securities laws unnecessary and militates against the Court finding the interest a security.[498] Since no other regulatory scheme governs the offer or sale of LLC interests or significantly reduces the risk to LLC investors, application of the securities laws appears necessary.[499] Given that LLC interests generally appear to satisfy each element of the family resemblance test, prosecutors and plaintiffs may argue courts should deem LLC interests to be interests "commonly known as a 'security.'"

2. Possible Defenses

LLC promoters can make a strong argument that neither the public's expectations nor the family resemblance test should determine whether an interest is an interest "commonly known as a 'security.'" As previously indicated, the phrase "commonly known as a 'security'" has not generated much litigation and there is little guidance from the courts on how to interpret the phrase.[500] There is no precedent indicating the public's expectations *alone* should dictate whether an interest is one that is "commonly known as a 'security.'"[501] Nor is there any precedent stating that a court should apply the *Reves* family resemblance test to determine whether an interest is one "commonly known as a 'security.'"[502] In fact, the United States Supreme Court indicated that, at least under the facts in *Forman*, it perceived no distinction between the test for "investment contract" and the test for "an instrument commonly known as a 'security.'"[503] The Court noted that in either case, the *Howey* test[504] should be used to determine whether the transaction involved a security.[505] Therefore, courts should use the *Howey* test, rather than a public expectations test or family resemblance test, to determine whether an interest or instrument is one "commonly known as a 'security.'"[506]

---

498. *Reves*, 494 U.S. at 67.

499. Steinberg Article, *supra* note 7, at 1122.

500. *See supra* notes 473-74 and accompanying text.

501. For example, in *Reves*, *Landreth*, and *Forman*, the public's expectations were only one of a number of factors considered by the Court. *See Reves*, 494 U.S. at 66-67 (adopting the family resemblance test and stating that the courts look to the buyers and seller's motivations, the plan of distribution, and the reasonable expectations of the investing public); Landreth Timber Co. v. Landreth, 471 U.S. 681, 685-97 (1985) (stating that the Court often looks to the language of the statute, the definition of security, the characteristics of the instrument, and the circumstances surrounding the transaction); United Hous. Found., Inc. v. Forman, 421 U.S. 837, 848-58 (1975) (considering the statutory definition of security, the purpose of the statute, and the public's expectations).

502. *See, e.g.*, *Reves*, 494 U.S. at 65-67 (stating that courts are to apply the family resemblance test to determine whether a "note" is a "security").

503. *Forman*, 421 U.S. at 852.

504. The *Howey* test, also known as the investment contract test, is set forth and discussed *supra* part III.A.

505. *Forman*, 421 U.S. at 852.

506. For a discussion of the *Howey* investment contract test and an analysis of when an LLC interest constitutes a security under the *Howey* test, see *supra* part III.A.

a. *Public's Expectations*

While the Court has indicated the investing public's expectations are relevant to determining whether an instrument is a security,[507] the Court has never stated the public's expectations are determinative.[508] The public's expectations were only one of many factors considered by the Court in these cases.[509] As a result, the public's expectations *alone* do not dictate whether an interest is a security.

Even if the public's expectations determined what interests were "commonly known as a 'security,'" LLC promoters may still argue that LLC interests are not securities. Commentators maintain, given the relatively recent origin of LLCs, it is unlikely that an LLC interest has reached the status of an interest "commonly known as a 'security.'"[510] Many investors do not even know about the LLC form of business organization, let alone whether the securities laws govern. The phrase "commonly known as a 'security'" appears more applicable to widely-used instruments, such as stock options.[511] Also, given the variety of business arrangements that may utilize the LLC form and the flexibility under the LLC statutes to vary the structure of the entity,[512] it is difficult to generalize about such entities. It seems ironic that entities which cannot be easily characterized because of their uniqueness would be treated as offering an interest "commonly known as a 'security.'"[513]

There is no evidence to indicate that investors expect LLC interests to be securities. Court documents filed in cases where the SEC alleged that LLC interests constituted securities indicate that the offering documents in these cases expressly disclosed that the interests did not constitute securities, were not registered under any securities laws, and were not subject to the protection of the securities laws.[514] Consequently, a reasonable investor would not expect the protection of the securities laws. Of course, the counter argument is that a seller may not effect a waiver of the securities laws by simply disclosing that the securities laws do not apply.[515] If the instrument is a security, the securities laws apply regardless of the disclosures made by the seller.

LLC promoters may also argue that LLCs share many of the characteristics of a general partnership.[516] Ordinarily, general partnership interests are

507. *See supra* notes 478-80 and accompanying text.
508. *See supra* note 501 and accompanying text.
509. *See supra* note 501.
510. Geu, Part Two, *supra* note 1, at 514.
511. *See id.*; 3 BLOOMENTHAL, *supra* note 94, § 2.04 [14]; 2 LOSS & SELIGMAN, *supra* note 99, at 1070-71.
512. *See, e.g., supra* note 468 and accompanying text.
513. *Cf.* 3 BLOOMENTHAL, *supra* note 94, § 2.04 [14], at 2-44 to 2-45.
514. *See, e.g.*, Defendants' Memorandum in Parkersburg at 9-11, (No 94-1079); Defendants' Memorandum in Vision at 3, 26, 1994 WL 326868 (No. 94-0615).
515. Securities Act of 1933 § 14, 15 U.S.C. § 77n (1994) ("Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."). A similar provision prevents waiver of the Exchange Act. *See* Securities Exchange Act of 1934 § 29(a), 15 U.S.C. § 78cc(a) (1994).
516. 1 RIBSTEIN & KEATINGE, *supra* note 1, § 14.02, at 14-4.

not considered securities.[517] Since LLCs and general partnerships share many of the same features, a reasonable investor would not assume the securities laws apply to LLCs. For these reasons, LLC promoters may argue an LLC interest may not be an interest "commonly known as a 'security.'"

b. *Family Resemblance Test*

The *Reves* Court adopted the family resemblance test to determine when an instrument denominated a "note" is a security.[518] The Court developed the test to expand the enumerated categories of instruments that are not securities.[519] There is no indication that the Court was attempting to develop a broader test or develop a test to determine whether an interest is one "commonly known as a 'security.'"[520] Additionally, each term in the definition of "security" is susceptible to a separate analysis, based on separate analytical concepts.[521] Therefore, an argument can be made that the family resemblance test only applies to notes.

As commentators have noted, the *Reves* test has created as much, if not more, confusion than it has eliminated.[522] The four-factor family resemblance test has been criticized by commentators as ambiguous enough to lead to a variety of interpretations.[523] In part, this is because the expectations of the investing public are not easily discernible.[524] Also, it is not clear what is meant by the term the "investing public."[525] Does it mean an average reasonable investor, a particular segment of the investing public, or those individuals who were offered the investment opportunity?[526] The *Reves* opinion provides little guidance.[527] In addition, the motivations of the buyer and seller are not easily discernible, and any interpretation of motivations tends to be highly subjective.[528] There is no indication in the *Reves* opinion how a court is to determine such motivations.[529] It is not clear whether a court should use a subjective or an objective test.[530] As a result, courts are left to consider self-serving testimony and are allowed to find the factors mean whatever the court decides they mean.[531]

---

517. *See supra* note 454.
518. Reves v. Ernst & Young, 494 U.S. 56, 65-70 (1990).
519. *Id.* at 65-67.
520. *See id.*
521. *See supra* note 440 and accompanying text; *cf. supra* note 441 and accompanying text.
522. Gordon, *supra* note 487, at 402-04; Kerr & Eisenhauser, *supra* note 487, at 1124 & n.6, 1133-57, 1162; Steinberg, *supra* note 487, at 678-85.
523. *See, e.g.*, Gordon, *supra* note 487; Kerr & Eisenhauser, *supra* note 487, at 1153; Schneider, *supra* note 134, at 129-36; Steinberg, *supra* note 487.
524. Lowenfels & Bromberg, *supra* note 463, at 560.
525. Kerr & Eisenhauser, *supra* note 487, at 1156.
526. *Id.*
527. *Id.*; *see* Reves v. Ernst & Young, 494 U.S. 56, 66 (1990).
528. Lowenfels & Bromberg, *supra* note 463, at 559-60.
529. *See Reves*, 494 U.S. at 66-67; Kerr & Eisenhauser, *supra* note 487, at 1153.
530. *See* Kerr & Eisenhauser, *supra* note 487, at 1153.
531. *Id.*; Schneider, *supra* note 134, at 135-36.

An analysis of court decisions applying the *Reves* test notes inconsistencies and ambiguities abound.[532] There is no agreement as to the meaning of each factor, or the ranking or relative weight of each factor.[533] The test creates a situation where courts may determine for other reasons what the outcome should be and then use the various factors of the family resemblance test to justify the result reached.[534]

Commentators have also criticized the family resemblance test on philosophical grounds.[535] To what extent should the application of the securities laws depend upon private impressions and personal motivations of those involved in a transaction?[536] The *Reves* test has been criticized for affording too much weight to private impressions and personal motivations, rather than emphasizing the public policy goals of the securities laws to protect the investing public and prevent fraud.[537]

3. Conclusions

The phrase "commonly known as a 'security'" appears applicable to interests more widely-used than LLCs.[538] Given the relatively recent origin of the LLC form,[539] the variety of organizational structures available,[540] and the fact it shares many of the same features as a general partnership,[541] it is doubtful that the LLC has reached the status of an interest "commonly known as a 'security.'"

The public's expectations are only one of many factors a court should consider in determining whether an interest is one that is "commonly known as a 'security.'"[542] Because the public's expectations are not easily discernible and such a highly subjective and speculative test would lead to inconsistent and unpredictable results, a determination should not rest on that factor alone.[543] Rather, the public's expectations should be considered as one of many relevant factors, as the Court has done to date.[544]

---

532. Kerr & Eisenhauser, *supra* note 487, at 1133-57, 1162.

533. *Id.* at 1153; Schneider, *supra* note 134, at 132-36.

534. Schneider, *supra* note 134, at 136.

535. *See* Lowenfels & Bromberg, *supra* note 463, at 559-60 (taking issue with whether the public's expectations and the motivations of the buyer and seller should be determinative on whether the federal securities laws apply).

536. *Id.* at 560.

537. *Id.* Professor Goforth argues that even if courts analyze LLC interests under the family resemblance test, LLC issuers can argue the interests are not securities under the test on the grounds that: (i) LLC interests are not expected to be traded for speculation or investment, since LLC interests typically have limited transferability; (ii) given that LLCs have been viewed principally as a replacement for general partnerships and general partnership interests are not securities, investors might not expect the securities laws to apply to LLCs; and (iii) there are at least two possible alternative regulatory schemes that reduce the risk of the investment, including various LLC statutes that offer investor protection and the Internal Revenue Code requirements that protect investors. Goforth, *supra* note 7, at 1254-70.

538. *See supra* note 511 and accompanying text.

539. *See supra* note 510 and accompanying text.

540. *See supra* notes 512-13 and accompanying text.

541. *See supra* notes 516-17 and accompanying text.

542. *See supra* notes 507-09 and accompanying text.

543. *See supra* notes 524-27, 531 and accompanying text.

544. *See supra* note 501 and accompanying text.

Nor should the courts use the family resemblance test in *Reves* to determine whether an interest is one that is "commonly known as a 'security.'" In light of the practical and philosophical problems with the *Reves* test,[545] there is little reason to broaden its application beyond its current narrow purpose to determine whether an instrument constitutes a "note." Given the criticism of the *Reves* test and the confusion it has caused, the *Reves* test appears an unlikely candidate for courts to use in determining whether an interest is one that is "commonly known as a 'security.'" For these reasons, neither the public's expectations test nor the *Reves* family resemblance test provides a satisfactory test from either a practical or philosophical standpoint for determining whether an LLC interest is a security.

E. *State Statutory Grounds for Liability*

1. Arguments Asserted

State legislatures have begun to take the initiative by passing legislation that either expressly states or implies that certain LLC interests are securities. For example, legislatures in eight states have amended their securities laws to expressly state certain LLC interests are securities.[546] Seven states have amended their securities laws to include references to LLCs.[547] Such references imply the offer and sale of LLC interests are subject to that state's securities laws. In addition, legislatures in four states have included provisions in their limited liability company acts that raise the securities law issue.[548] All of these statutes provide prosecutors and civil plaintiffs with state law grounds for arguing that certain LLC interests are securities.

States have adopted three different types of securities law statutes to expressly address whether LLC interests are securities. The first type of statute specifically lists LLC interests in the state securities act definition of a "security."[549] If the legislature expressly lists LLC interests in the definition of a

---

545. *See supra* notes 522-37 and accompanying text.

546. ALASKA STAT. § 45.55.990(12) (1994); CAL. CORP. CODE § 25019 (West Supp. 1995); IND. CODE ANN. § 23-2-1-1(k) (West 1995); N.M. STAT. ANN. § 58-13B-2(V) (Michie Supp. 1995); OHIO REV. CODE ANN. § 1707.01(B) (Baldwin Supp. 1995); PA. STAT. ANN. tit. 70, § 1-102(t) (Supp. 1995); VT. STAT. ANN. tit. 9, § 4202a(14) (Supp. 1995); WIS. STAT. ANN. § 551.02(13)(c) (West Supp. 1995). Table II of this article contains a listing of the state statutes that expressly address whether LLC interests are securities under state law. Table II is organized alphabetically by state and provides the statutory citation, a short summary of the statutory provision, and quotes the relevant language.

547. *See, e.g.*, CONN. GEN. STAT. ANN. § 36b-1 (West Supp. 1995) (general statement); IOWA CODE ANN. § 502.207A(2)(a) (West Supp. 1995) (expedited registration); KAN. STAT. ANN. § 17-1262(l) (Supp. 1994) (exempt transactions); LA. REV. STAT. ANN. § 51:709(12) (West Supp. 1995) (exempt transactions); N.D. CENT. CODE § 10-04-05 (1995) (exempt securities); N.H. REV. STAT. ANN. § 421-B:17(II)(k) (Supp. 1994) (registration exemption); VA. CODE ANN. § 13.1-514(B)(7)(b) (Michie Supp. 1995) (exempt transactions).

548. GA. CODE ANN. § 14-11-1107(n) (1994); MICH. COMP. LAWS ANN. § 450.5103 (West Supp. 1995); MO. ANN. STAT. § 347.185 (Vernon Supp. 1994); WIS. STAT. ANN. § 183.1303 (West Supp. 1995). Table II of this article sets forth the relevant statutory language of the Georgia, Michigan, Missouri, and Wisconsin statutes.

549. *See, e.g.*, ALASKA STAT. § 45.55.990(12); N.M. STAT. ANN. § 58-13B-2(V); OHIO REV. CODE ANN. § 1707.01(B); VT. STAT. ANN. tit. 9, § 4202a(14). For example, the Ohio statute provides "'security' means any . . . membership interests in limited liability companies . . . ." For the

"security," prosecutors and plaintiffs may argue that state securities laws apply to *all* LLC interests offered and sold in that state. In such states, courts no longer need to determine whether LLC interests are securities under the investment contract test or a risk capital analysis.[550] A court's inquiry is limited to whether the interest being offered or sold is an LLC interest.[551] Prosecutors and plaintiffs can assert that by explicitly enumerating LLC interests in the list of items that are "securities," the legislature mandated all LLC interests are securities and all LLC investors are entitled to the protection of the state's securities laws. They may assert that by including LLC interests in the definition the legislature effectively eliminated all judicial interpretation and discretion.

The second type of statute also lists LLC interests in the state securities act definition of a "security," but, in addition, such statutes state that an LLC interest is not a security under certain specified circumstances.[552] For example, some statutes state that an LLC interest is not a security when all of the members of the LLC are actively engaged in the management of the LLC.[553] Moreover, some of the exclusionary provisions shift the burden of proof.[554] In states adopting this statutory structure, prosecutors and plaintiffs would also be able to argue that LLC interests are securities without having to apply the investment contract test or any risk capital analysis.[555] Litigants will battle instead over whether the LLC interests meet the exclusionary conditions. But these statutory conditions are subject to judicial interpretation. Courts may draw on the *Howey* and risk capital lines of cases to interpret exclusionary conditions such as "actively engaged in the management of the LLC."[556] With the new, specific statutory language, however, the issues are more limited and courts are not bound by precedent relating to the investment contract test or risk capital test. Prosecutors and plaintiffs can argue that courts are free

---

relevant text of the Alaska, New Mexico, and Vermont statutes, see *infra* Table II.

550. In *Reves, Landreth,* and *Gould,* the United States Supreme Court held that the *Howey* investment contract test and the economic reality approach do not apply in cases involving instruments specifically listed in the statutory definition of a "security," other than to cases involving the catch-all category of "investment contracts." *See* Reves v. Ernst & Young, 494 U.S. 56, 64 (1990); Landreth Timber Co. v. Landreth, 471 U.S. 681, 691-92 & n.5 (1985); Gould v. Ruefenacht, 471 U.S. 701, 704 (1985). If LLC interests are expressly listed in the definition of a "security," prosecutors and plaintiffs can argue similarly that the investment contract test, the economic reality approach, and the risk capital analysis do not apply. For a discussion of the investment contract test and risk capital tests, see *supra* parts III.A and III.B, respectively.

551. Ribstein, *supra* note 7, at 838-39 & n.110. The court need only determine whether the firm was a properly formed LLC. *Id.* at n.110.

552. *See, e.g.*, CAL. CORP. CODE § 25019; IND. CODE ANN. § 23-2-1-1(k); PA. STAT. ANN. tit. 70, § 1-102(t). For the relevant text of these statutes, see *infra* Table II.

553. *See, e.g.*, CAL. CORP. CODE § 25019; IND. CODE ANN. § 23-2-1-1(k).

554. *See, e.g.*, IND. CODE ANN. § 23-2-1-1(k) ("'Security' does not include . . . an interest in a limited liability company if the person claiming that the interest is not a security can prove that all of the members of the limited liability company are actively engaged in the management of the limited liability company.").

555. *See supra* note 550.

556. Courts may draw on the *Howey* "efforts of others" analysis or the risk capital test control analysis. For a discussion of the cases dealing with these issues, see *supra* parts III.A and III.B, respectively.

to adopt narrower interpretations crafted to reflect the legislature's intent to provide greater protection for LLC investors.

The third type of statute sets forth certain presumptions in its definition of a "security."[557] For example, such statutes may state that a "security" is presumed to include an LLC interest if the right to manage the LLC is vested in one or more managers or if the aggregate number of members exceeds a specified number.[558] Similarly, such statutes may also state a "security" is not presumed to include an interest in an LLC if the aggregate number of members is below a specified number.[559] If the LLC interest in question meets the statutory conditions that give rise to the presumption that the interest is a security, prosecutors and plaintiffs can claim the legislature provided the court with clear guidance—practically a bright-line test.[560] However, if the LLC interest in question does not meet the conditions giving rise to the presumption, all is not lost. The presumptions are rebuttable, although they may shift the burden of proof.[561] Prosecutors and plaintiffs can probably present a *Howey*-type analysis in an attempt to overcome the presumptions.[562] Litigation can also focus on interpreting the language of the statute. For example, when is the right to manage the LLC vested in one or more managers?[563] In an attempt to provide guidance, the legislature may have added simply another layer of analysis and more confusion. Nevertheless, such statutes provide additional grounds to argue that an LLC interest is a security. Moreover, because the presumption is rebuttable, the statute does not preclude arguments on other grounds.

In addition, a number of states have amended their securities laws to include references to LLCs[564] and several states have included provisions in their limited liability company act that raise the securities law issues.[565] Prosecutors and plaintiffs may claim these provisions evidence legislative intent. They may argue that by passing such provisions, the legislature indicated that LLC interests are securities and that LLC investors are to be afforded the protection of the state's securities laws. All of the statutes discussed in this

---

557. *See, e.g.*, WIS. STAT. ANN. § 551.02(13)(c) (West Supp. 1995). For the relevant text of this statute, see *infra* Table II.

558. *Id.*

559. *Id.*

560. Sargent Blue Sky, *supra* note 7, at 437 (discussing the Wisconsin approach). Prosecutors and plaintiffs may assert that the presumptions indicate legislative intent. Interests in an LLC with less than the specified number of members are not securities, while interests in an LLC with more than the specified number of members are securities. *Id.*

561. *See, e.g.*, FED. R. EVID. 301. The federal rules of evidence, for example, provide that a "presumption imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption." *Id.*

562. A discussion of the *Howey* analysis is presented *supra* part III.A.

563. Is the "right to manage" satisfied by an operating agreement that vests management of the LLC in its members, even if some members do not actually participate in its management? Or does the "right to manage" not only require the vesting of management rights in its members, but also actual exercise of those rights? Louis R. Briska, *When Does a Member's Interest in an LLC Become a Security?*, 67 WIS. LAW., Sept. 1994, at 18, 20.

564. *See supra* note 547 and accompanying text.

565. *See, e.g.*, GA. CODE ANN. § 14-11-1107(n) (1994); MICH. COMP. LAWS ANN. § 450.5103 (West Supp. 1995). For the relevant text of these statutes, see *infra* Table II.

section provide prosecutors and plaintiffs with state law grounds for arguing certain LLC interests are securities.

2. Possible Defenses

LLC issuers can challenge state statutory provisions, that either expressly state or imply certain LLC interests are securities, on a number of grounds. They may argue that a statutory characterization of an LLC interest as a "security" is not necessarily conclusive, since the clause preceding many definitional sections provides "unless the context otherwise requires," thereby mandating a review of the surrounding factual circumstances.[566] Also, several of these statutory provisions may be vulnerable to attack on constitutional grounds for discriminating between domestic and foreign LLCs.[567] Moreover, all such statutory provisions are subject to judicial interpretation.[568]

LLC issuers can argue that including LLC interests in the statutory laundry list of interests deemed "securities" does not mean all LLC interests are automatically "securities."[569] They can contend that such statutory characterizations are not conclusive. Inclusion in the list merely tilts the analytical scale by creating a kind of presumption that simply makes it more difficult to establish the interest is not a security, but not impossible.[570]

This argument is premised on the fact that the definitional sections of the federal securities acts[571] and most state securities acts[572] begin with the qualifying language "unless the context otherwise requires." Courts have interpreted the context clause as authorizing judicial exclusion of certain instruments on the basis of factual circumstances, even if an instrument falls within the statutory definition of a security.[573] For example, the United States Supreme Court held in *Reves v. Ernst & Young*[574] that the phrase "any note" in the federal securities acts should not be interpreted to mean literally "any note," but must be interpreted in light of what Congress was attempting to accomplish.[575] The Court concluded that Congress was concerned with regulating the investment markets, not with creating a general cause of action for

566. *See infra* notes 569-82 and accompanying text.
567. *See infra* notes 583-85 and accompanying text.
568. *See infra* notes 586-96 and accompanying text.
569. Sargent Blue Sky, *supra* note 7, at 436 (discussing New Mexico's statutory definition of a "security").
570. *Id.*
571. Securities Act of 1933 § 2, 15 U.S.C. § 77b (1994); Securities Exchange Act of 1934 § 3, 15 U.S.C. § 78c(a) (1994).
572. UNIF. SEC. ACT § 401 (1958), 7B U.L.A. 578 (1985); UNIF. SEC. ACT § 101 (1988), 7B U.L.A. 91 (Supp. 1995); *see also* ALASKA STAT. § 45.55.990 (1994); CAL. CORP. CODE § 25001 (West 1977); IND. CODE ANN. § 23-2-1-1 (West 1995); PA. STAT. ANN. tit. 70, § 1-102 (Supp. 1995); WIS. STAT. ANN. § 551.02 (West Supp. 1995).
573. *See, e.g.*, Reves v. Ernst & Young, 494 U.S. 56 (1990) (excluding certain notes); Marine Bank v. Weaver, 455 U.S. 551, 558-59 (1982) (excluding certain certificates of deposit). For an excellent critique of the United States Supreme Court's interpretation of the context clause, see Marc I. Steinberg & William E. Kaulbach, *The Supreme Court and the Definition of a "Security": The "Context" Clause, "Investment Contract" Analysis, and Their Ramifications*, 40 VAND. L. REV. 489 (1987); *see also* 2 LOSS & SELIGMAN, *supra* note 99, at 873-75.
574. 494 U.S. 56 (1990).
575. *Reves*, 494 U.S. at 63.

all fraud.[576] Therefore, courts must look at the surrounding factual circumstances, including the offering context,[577] to determine if a particular note is a "security." The Court then held that many types of notes would not be treated as securities, despite inclusion of the phrase "any note" in the statutory definition of a "security."[578]

Citing a context clause, LLC issuers can argue courts are permitted to carve out a relatively broad category of LLC interests as not constituting securities.[579] They can claim the context clause is intended to provide courts some latitude to use judicial discretion and to avoid mindless, literal interpretation.[580] They can also argue that categorically defining all LLC interests as securities is undesirable because it is over-inclusive.[581] While certain interests may be within the letter of the statute, such broad coverage is not within the spirit or intent. For instance, there is no justification for imposing all of the consequences of the securities laws on a closely held LLC where all the members are actively engaged in the management of the LLC.[582]

Also, at least two of the statutes that include LLC interests in the definition of a "security" may be subject to attack on constitutional grounds. The definition of a "security" in Alaska provides that a "security" means an LLC interest as defined in title 10, chapter 50 of the Alaska Statutes.[583] The definition of a "security" in Wisconsin includes presumptions about interests in LLCs organized under chapter 183 of the Wisconsin Statutes.[584] Both provisions appear to apply only to domestically organized LLCs. Presumably, LLCs organized in other jurisdictions would be subject to an investment contract or risk capital analysis. Professor Mark Sargent charges that this differential treatment of domestic and foreign LLCs may be vulnerable to constitutional attack under the Commerce Clause as either being discriminatory against or placing an undue burden on interstate commerce.[585]

Even if a state has adopted a statute that lists LLC interests in the definition of a "security," many of the statutes contain exclusionary conditions[586] or the statute may merely set forth a presumption.[587] Since the exclusionary conditions and presumptions often turn on whether members are engaged in the management of the LLC,[588] the conditions and presumptions are subject

576. *Id.* at 65.
577. *See id.* at 62-67.
578. *Id.* at 64-67.
579. Sargent Blue Sky, *supra* note 7, at 436 (discussing the New Mexico securities statute).
580. 3 BLOOMENTHAL, *supra* note 94, § 2.01, at 2-5.
581. McGinty, *supra* note 270, at 1039; Sargent Blue Sky, *supra* note 7, at 438.
582. Sargent Blue Sky, *supra* note 7, at 438-39.
583. ALASKA STAT. § 45.55.990(12) (1994). Title 10, chapter 50 of the Alaska Statutes includes provisions dealing with the formation of LLCs. *See* ALASKA STAT. § 10.50 (Supp. 1995). For a definition of "limited liability company" and "limited liability company interest," see ALASKA STAT. § 10.50.990. Both definitions refer to LLC entities organized under Alaska law. *Id.*
584. WIS. STAT. ANN. § 551.02(13)(c) (West Supp. 1995). For the relevant text of the Wisconsin statute see *infra* Table II. Chapter 183 of the Wisconsin Statutes deals with LLCs organized in Wisconsin. *See* WIS. STAT. ANN. § 183 (West Supp. 1995).
585. SARGENT HANDBOOK, *supra* note 1, § 4.03[1][a], at 4-16 to 4-17.
586. *See* CAL. CORP. CODE § 25019; IND. CODE ANN. § 23-2-1-1(k); PA. STAT. ANN, tit. 70, § 1-102(t).
587. *See* WIS. STAT. ANN. § 551.02(13)(c).
588. See, for example, the language of the California, Indiana, Pennsylvania, and Wisconsin

to interpretation. LLC issuers can argue for a broad interpretation of what constitutes member management.[589] They can continue to assert that LLCs are closely analogous to general partnerships,[590] thus courts should draw on the *Howey* line of cases dealing with general partnership interests to determine who has the right to manage the LLC or whether members are engaged in the management of the LLC.[591] Interpretation of these conditions and presumptions open the door for LLC issuers to cite case law dealing with general partnership interests and argue for a strong presumption that LLC interests are not securities.[592]

LLC issuers can also argue provisions in LLC acts that raise the securities law issue[593] and the various references to LLCs in state securities law statutes[594] are not evidence of legislative intent to treat all LLC interests as securities. Most of the provisions in the LLC acts simply raise the securities law issue and leave it to the courts to decide whether an LLC interest is a security.[595] LLC issuers can argue that references to LLCs in state securities law registration and exemption provisions simply indicate that the legislature recognized a court *may* find an LLC interest to be a security under the investment contract test or a risk capital analysis.[596] By adding references to LLCs, the legislature was merely making certain that registration and exemption provisions are available for LLC offerings. If the legislature intended that all LLC interests be treated as securities, then it would have amended the state laws to provide so, rather than including sporadic references to LLCs. As a result, such provisions are not dispositive of legislative intent.

Challenges to state statutory provisions on the basis of a context clause, constitutionality, interpretation, or legislative intent may serve to undercut the

---

statutes set forth *infra* Table II.

589. Such statutes tend to exclude LLC interests if the members are actively engaged in the management of the LLC. *See, e.g.*, IND. CODE ANN. § 23-2-1-1(k)(iii). Therefore, a broad definition of what constitutes management would tend to exclude more LLC interests from coverage under the securities laws.

590. *See supra* notes 243-50 and accompanying text.

591. For a discussion of the *Howey* line of cases dealing with partnership interests and a discussion of the arguments LLC issuers may make, see *supra* part III.A.2.

592. Several courts have stated there is a strong presumption that general partnership interests are not securities under the *Howey* investment contract test. *See supra* note 241 and accompanying text.

593. *See, e.g.*, GA. CODE ANN. § 14-11-1107(n) (1994); MICH. COMP. LAWS ANN. § 450.5103 (West Supp. 1995); WIS. STAT. ANN. § 183.1303 (West Supp. 1995). For the relevant text of the Georgia, Michigan, and Wisconsin statutes, see *infra* Table II.

594. *See, e.g.*, CONN. GEN. STAT. ANN. § 36b-1 (West Supp. 1995); IOWA CODE ANN. § 502.207A(2)(a) (West Supp. 1995); KAN. STAT. ANN. § 17-1262(l) (Supp. 1994); LA. REV. STAT. ANN. § 51:709(12) (West Supp. 1995); N.D. CENT. CODE § 10-04-05(4), (10), (11), (13) (1995); N.D. CENT. CODE § 10-04-06(4), (6), (10), (14) (1995); N.D. CENT. CODE § 10-04-07(2)(b)(3) (1995); N.H. REV. STAT. ANN. § 421-B:11(II) (Supp. 1994); N.H. REV. STAT. ANN. § 421-B:13(I) (Supp. 1994); N.H. REV. STAT. ANN. § 421-B:17(II)(k) (Supp. 1994); VA. CODE ANN. § 13.1-514(B)(7)(b) (Michie Supp. 1995).

595. *See, e.g.*, GA. CODE ANN. § 14-11-1107(n) ("Nothing in this chapter shall be construed as establishing that a limited liability company interest is not a 'security'. . . ."); WIS. STAT. ANN. § 183.1303 ("An interest in a limited liability company may be a 'security'. . . .").

596. For a discussion of the grounds for finding that an LLC interest is a security under the investment contract test or risk capital analysis, see *supra* parts III.A and III.B.

statutory arguments made by prosecutors and plaintiffs. If nothing else, such challenges provide grounds for increased litigation.

3. Conclusions

Prosecutors and plaintiffs have a very strong argument that all LLC interests are securities in states that specifically list LLC interests, without any qualifications or conditions, in the state securities law definition of a "security."[597] Several states do not have context clauses preceding the statutory definitions.[598] Clearly all LLC interests are securities in such states.

Even in states where the definitional section begins with a context clause qualification, prosecutors and plaintiffs have strong arguments that all LLC interests in such states are securities. They may argue that the United States Supreme Court has repeatedly said that the "starting point in every case involving construction of a statute is the language itself."[599] The context clause usually does not modify the term "security" in particular, but generally precedes a long list of general definitions.[600] Early drafts of the proposed federal securities laws show the context clause language was intended to refer to the context in which the defined terms appeared in the statute itself.[601] The context clause only meant that the same words may have different meanings in different parts of the same act. Parties may argue the context clause was not meant to refer to the context of the underlying transaction.[602] Given the legislative intent, prosecutors and plaintiffs may contend that courts should not use the context clause to justify excluding any LLC interests from the definition of a "security" on the basis of the offering context.

The *Landreth*[603] case also provides prosecutors and plaintiffs with grounds for arguing that the plain meaning of the statutory language should control. In *Landreth*, the United States Supreme Court held that since the term "stock" was plainly within the statutory definition of a "security," the plain meaning of the statute mandated that the stock in question be treated as a security.[604] There was no reason to examine the offering context or underlying transaction.[605] Similarly, prosecutors and plaintiffs can argue that inclusion of LLC interests in the definition of a "security" mandates that all LLC interests must be treated as securities.

---

597. *See, e.g.*, OHIO REV. CODE ANN. § 1707.01 (Baldwin Supp. 1995); VT. STAT. ANN. tit. 9, § 4202a (1993 & Supp. 1995).

598. *See, e.g.*, OHIO REV. CODE ANN. § 1707.01; VT. STAT. ANN. tit. 9, § 4202a.

599. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring); *accord* Landreth Timber Co. v. Landreth, 471 U.S. 681, 685 (1985); International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 558 (1979).

600. *See, e.g.*, Securities Act of 1933 § 2, 15 U.S.C. § 77b (1994); Securities Exchange Act of 1934 § 3, 15 U.S.C. § 78c(a) (1994); UNIF. SEC. ACT § 401 (1958), 7B U.L.A. 578 (1985); UNIF. SEC. ACT § 101 (1988), 7B U.L.A. 91 (Supp. 1995).

601. For a discussion of early drafts of the federal securities laws and the context clause language, see Steinberg & Kaulbach, *supra* note 573, at 504-05 & n.91; *see also* Gary S. Rosin, *Functional Exclusions from the Definition of a Security*, 28 S. TEX. L. REV. 333, 363-64 (1986).

602. Steinberg & Kaulbach, *supra* note 573, at 504.

603. Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985).

604. *Id.* at 687, 697.

605. *Id.* at 690.

Even though the United States Supreme Court excluded certain notes and certificates of deposits from the definition of a "security" based on factual context,[606] prosecutors and plaintiffs can argue that such cases are distinguishable. Changes in the usage of notes and certificates of deposits by the financial community over time and significant variations in the character of these instruments resulted in changes in their meanings.[607] Although both terms are listed in the definition of a "security,"[608] the terms no longer have well-settled meanings.[609] The Court therefore looked behind the labels to the offering context to determine if instruments labeled notes and certificates of deposits should be treated as securities.[610] Prosecutors and plaintiffs, however, may argue LLC interests are different. LLC interests are not some unusual type of financial instrument.[611] Neither the meaning of the term nor the character of LLC interests have changed. There is no need to look beyond the characteristics of the instrument. The legislature meant what it said: LLC interests are securities. The plain meaning of the statute should control. No justification exists for judicial modification of the statutory terms based on the factual situation because legislative intent is clear.

By including LLC interests in the statutory definition of a "security," the legislature presumably intended to provide some certainty and predictability.[612] The legislature wished to make clear that certain LLC interests are securities. If courts begin to use the context clause to exclude interests that clearly fit within the statutory definition, courts will undermine the legislative purpose. Such exclusions create uncertainty.[613] When courts do not apply the law according to its express terms, they reduce the public's ability to understand what the law requires of them. Without lawyers, discovery, and litigation, neither LLC issuers nor investors will know whether their transaction is covered by the securities laws. In the interest of predictability and clarity, courts should resist judicially excluding interests expressly listed in the definition. Moreover, the statutes neither define nor even suggest the scope of the context clause.[614] Nor have courts ever really elaborated on the precise

606. *See* Reves v. Ernst & Young, 494 U.S. 56 (1990) (stating that a note may or may not be a security); Marine Bank v. Weaver, 455 U.S. 551 (1982) (holding that a certificate of deposit purchased from a federally regulated bank is not a security).

607. *See Reves*, 494 U.S. at 62-63 (discussing notes); *Landreth*, 471 U.S. at 694 (discussing notes); *Marine Bank*, 455 U.S. at 557-58 & n.5 (discussing certificates of deposit); *see also* 2 LOSS & SELIGMAN, *supra* note 99, at 875 n.18 (tracing changes in the meaning of the term note).

608. *See, e.g.*, Securities Act of 1933 § 2, 15 U.S.C. § 77b(1); Securities Exchange Act of 1934 § 3, 15 U.S.C. § 78c(a)(10); UNIF. SEC. ACT § 401(l) (1958), 7B U.L.A. 578 (1985).

609. *See supra* note 607 and accompanying text.

610. *See Reves*, 494 U.S. at 64-70 (addressing notes); *Marine Bank*, 455 U.S. at 555-59 (discussing certificates of deposit).

611. *Cf. Landreth*, 471 U.S. at 689-90 n.4 (noting that cases where the Court looked at the economic reality of the transaction usually "involved unusual instruments that did not fit squarely within one of the enumerated specific kinds of securities listed in the definition").

612. If a securities act does not list LLC interests in its definition of a security, courts generally must conduct a case-by-case investment contract or risk capital analysis to determine if the interest is a security. *See* discussion *supra* parts III.A and III.B.

613. *See* Gary S. Rosin, *Historical Perspectives on the Definition of a Security*, 28 S. TEX. L. REV. 575, 618 (1987); Steinberg & Kaulbach, *supra* note 573, at 490.

614. McGinty, *supra* note 270, at 1039.

role of the context clause.[615] Courts should not expand the use of this vague concept which creates uncertainty and allows for unbounded judicial discretion.[616] Courts should apply the statute according to its express terms, rather than using the context clause to embark down the road of judicial activism.

Courts should also resist LLC issuer efforts to draw on the *Howey* line of cases dealing with general partnership interests in interpreting statutory phrases dealing with LLC interests. If the legislature intended courts simply to apply the *Howey* investment contract test, any references to LLCs in the definition would be superfluous. It may be argued that by including a reference to LLCs in the definition of a "security," the legislature intended to provide greater guidance to the courts than the *Howey* test provides, and possibly more certainty and increased investor protection. Following a *Howey* line of cases would undermine the legislature's intent. The new statutory language frees the courts to adopt judicial interpretations that provide greater investor protection and more certainty. As a result, state statutes that address the issue of whether LLC interests are securities may provide prosecutors and plaintiffs with some very powerful weapons in arguing that LLC interests are securities.

IV. CONCLUSIONS

While commentators are divided on the issue of whether LLC interests should be treated as securities,[617] the SEC and at least thirty-five state securities commissions have taken the position that certain LLC interests may be securities.[618] Commentators, the SEC, and state securities agencies have advanced five different legal theories in their attempts to bring LLC offerings within the ambit of the securities laws. These theories include the investment contract test, the risk capital test, the characteristics of stock test, the commonly known as a security test, and state statutory grounds. Clearly certain LLC interests can be securities under the *Howey* investment contract test and a risk capital analysis.[619] While prosecutors and plaintiffs may make colorable arguments that LLC interests are securities under the characteristics of stock test or the commonly known as a security test,[620] such arguments probably will not prevail. In light of both practical and philosophical problems, there is little reason to broaden the application of the characteristics of stock test or the commonly known as a security test to cover LLC interests.[621] The recent passage of state statutes defining certain LLC interests as securities provides prosecutors and plaintiffs with additional state law grounds for arguing LLC interests are securities.[622] While such statutes are subject to judicial interpre-

615. *See* Steinberg & Kaulbach, *supra* note 573, at 490-91.
616. McGinty, *supra* note 270, at 1039; Rosin, *supra* note 601, at 361-64; Steinberg & Kaulbach, *supra* note 573, at 511-12.
617. *See supra* note 7.
618. *See supra* notes 8-19 and accompanying text.
619. *See supra* parts III.A.1, III.A.3, III.B.1, and III.B.3.
620. *See supra* parts III.C.1 and III.D.1.
621. *See supra* parts III.C.2, III.C.3, III.D.2, and III.D.3.
622. *See supra* parts III.E.1 and III.E.3.

tation, these statutes may prove to be a powerful weapon for prosecutors and plaintiffs attempting to apply the securities laws to LLC offerings.

As courts grapple with these various legal theories to determine whether LLC interests are securities, they will have the opportunity to refine and develop the definition of a security. How the courts apply the securities laws to the offer and sale of LLC interests will determine the degree of protection afforded investors. Absent legislative action, courts will use the *Howey* investment contract test and the risk capital tests to determine whether an LLC interest is a security.[623] The formulation of the *Howey* test and the risk capital tests, the remedial purpose of the securities laws,[624] the hybrid nature of the LLC entity, and the recent proliferation of fraudulent LLC schemes,[625] all compel the conclusion that each LLC offering must be analyzed on a case-by-case basis. Courts must focus on the substance, not the form, of each transaction and examine the economic realities of the transaction, not just the operating documents.[626] Applying general partnership case law and its related presumptions to LLC offerings is inappropriate and will lead to undesirable results.[627] If the courts determine there is a need for presumptions to provide clear, predictable rules, they should presume that LLC interests are securities.[628] The costs associated with such a presumption would be minimal in most situations, but the protection provided investors would be great. However, if the goal is truly clarity, predictability, and maximizing investor protection, the best approach would be for legislatures to enact legislation expressly stating that all LLC interests are securities.[629]

---

623. *See supra* parts III.A.3 and III.B.3.

624. *See, e.g.*, Tcherepnin v. Knight, 389 U.S. 332, 336 (1967); SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 479-80 (5th Cir. 1974); Fortier v. Ramsey, 220 S.E.2d 753, 755 (Ga. Ct. App. 1975).

625. *See supra* notes 81-87 and accompanying text; *see also Division of Enforcement Warns of Fraud in the Sale of Unregistered Securities of Telecommunications Technology Ventures*, News Release, SEC 94-105, 1994 WL 507361 (SEC) (Sept. 16, 1994) (explaining that fraudulent telecommunications technology ventures frequently take the form of LLCs); Jim McTague, *Regulators Say Cable-TV Investment Scams Are Rampant*, BARRON'S, Sept. 5, 1994, at 15 (explaining that "scamsters" try to steer clear of securities regulators by using LLCs); Ellen E. Schultz, *IRA Money May Attract Shady Deals*, WALL ST. J., Dec. 7, 1994, at C1 (reporting that many of the deals are packaged as LLCs).

626. *See supra* parts III.A.3 and III.B.3.

627. *See supra* part III.A.3.

628. *See supra* notes 324-29 and accompanying text.

629. *See, e.g.*, OHIO REV. CODE ANN. § 1707.01(B) (Baldwin Supp. 1995); VT. STAT. ANN. tit. 9, § 4202a(14) (Supp. 1995).

TABLE I: SUMMARY OF STATE ACTIONS UNDER STATE SECURITIES LAWS AGAINST DEFENDANTS OFFERING OR SELLING LLC INTERESTS[630]

State	Action	Business	Action Taken	Findings	Securities Law Violations Addressed	Legal Theories Discussed
Colo.	Feigin v. Infotech Group, Inc., No. 94 CV 1756, 1994 Colo. Sec. LEXIS 1 (Apr. 8, 1994)	wireless cable television system	Temporary Restraining Order Issued	· Summary Order, restating state allegations	· unregistered securities · unregistered broker-dealers and sales representatives · antifraud violations	· investment contract theory[631]
Ga.	Report and Recommendation of Referee, Cleland v. Express Communications, Inc., No. 50-93-0075 (Ga. Mar. 23, 1994)	wireless telecommunication services	Hearing Officer Recommended Entry of Cease and Desist Order	· Findings of Fact · Conclusions of Law · Reasoned Opinion and Analysis of Law	· unregistered securities · unregistered issuer, salesperson, and dealer	· investment contract theory · risk capital test · certificate of interest or participation in profit sharing *agreement* · characteristics of stock test[632]
Ill.	*In re* Express Communications, Inc., No. 9200106, 1993 WL 566300 (*Ill. Sec. Dep't*) (Dec. 13, 1993) [Illinois Express Action]	wireless telecommunication services	Order of Prohibition Issued	· Findings of Fact · Conclusions of Law · Reasoned Opinion and Analysis of Law	· unregistered securities · unregistered dealer and salesperson	· investment contract theory · risk capital test
Ind.	*In re* Express Communications, Inc., No. 93-0027 CD, 1993 Ind. Sec. LEXIS 46 (Mar. 23, 1993) [Indiana Express Action]	interactive and wireless telecommunication services	Cease and Desist Order Issued	· Summary Order, restating state allegations	· unregistered securities · unregistered broker-dealer or agent · antifraud violations	· investment contract theory
Ind.	*In re* Wireless Cable Fin. Consultants, No. 93-0094 CD, 1993 Ind. Sec. LEXIS 170 (Nov. 19, 1993)[633]	wireless cable television system	Cease and Desist Order Issued	· Summary Order, restating state allegations	· unregistered securities · unregistered broker-dealer or agent · antifraud violations	· no legal theory addressed, only statutory definition of "security" cited

[630] Table I does not purport to be a complete listing of all state actions under state securities laws against defendants offering or selling LLC interests. *See supra* notes 13 and 84.

[631] Legal theory asserted by state in Complaint.

[632] Legal theory rejected by hearing officer.

[633] For resolution of this matter see *In re* Wireless Cable Fin. Consultants, No. 93-0094 CD, 1994 Ind. Sec. LEXIS 45 (May 9, 1994) (setting forth Consent Agreement, Compliance Agreement, and Order of Withdrawal with respect to certain named defendants).

State	Action	Business	Action Taken	Findings	Securities Law Violations Addressed	Legal Theories Discussed
Ind.	*In re* Knoxville Ltd. Liab. Co., No. 95-0023 CD, 1995 Ind. Sec. LEXIS 38 (Mar. 24, 1995) [Indiana Knoxville Action]	wireless cable industry	Cease and Desist Order Issued	· Summary Order, based on state allegations	· unregistered securities · unregistered agents and/or broker-dealers · antifraud violations	· investment contract theory · IND. CODE ANN. § 23-2-1-1(k) which defines certain LLC interests as securities
Ind.	*In re* Spectrum Resources Group, Ltd., No. 94-0050 CD, 1994 Ind. Sec. LEXIS 96 (Sept. 15, 1994) [Indiana Spectrum Action]	wireless television system	Cease and Desist Order Issued	· Summary Order, based on state allegations	· unregistered securities · unregistered agents and/or broker-dealers · antifraud violations	· IND. CODE ANN. § 23-2-1-1(k) which defines certain LLC interests as securities
Kan.	*In re* Wireless Solutions, Inc., No. 95E011, 1994 WL 480778 (Kan. Sec. Comm'r) (Aug. 18, 1994)	wireless cable system	Emergency Cease and Desist Order Issued	· Summary Order, restating state allegations	· unregistered securities · unregistered agents and/or broker-dealers · antifraud violations	· no legal theory addressed, only statutory definition of a "security" cited
Kan.	*In re* Parkersburg Wireless, L.L.C., No. 94E068, 1994 WL 245870 (Kan. Sec. Comm'r) (May 18, 1994) [Kansas Parkersburg Action]	wireless cable television system	Emergency Cease and Desist Order Issued	· Summary Order, restating state allegations	· unregistered securities · unregistered broker-dealer or agent · antifraud violations	· no legal theory addressed, only statutory definition of "security" cited
Kan.	*In re* UEG, L.C., No. 93E068, 1993 WL 208898 (Kan. Sec. Comm'r) (May 12, 1993)	wireless cable television system	Emergency Cease and Desist Order Issued	· Summary Order, restating state allegations	· unregistered securities · unregistered broker-dealer or agent · antifraud violations	· no legal theory addressed, only statutory definition of "security" cited
Kan.	*In re* Hancock Communications Riverside PCS, No. 93E-058, 1993 WL 145928 (Kan. Sec. Comm'r) (Apr. 14, 1993)	wireless and wireline telecommunication services	Emergency Cease and Desist Order Issued	· Summary Order, restating state allegations	· unregistered securities · unregistered broker-dealer	· investment contract referenced · statutory definition of "security" cited
Minn.	*In re* Replen-K, Inc., Nos. SE 9209063, SE 9301897, SE 9304735, 1993 WL 451199 (Minn. Dept. Comm.) (Oct. 7, 1993)	not stated	Cease and Desist Order Issued	· Summary Order	· unregistered securities · unregistered sales	· no legal theory addressed, summary conclusion stated
Mo.	*In re* Wireless Cable Fin. Consultants, No. CD-94-08, 1994 Mo. Sec. LEXIS 31 (Mar. 3, 1994) [Missouri Wireless Cable Action]	wireless cable television station	Cease and Desist Order Issued	· Summary Order, restating state allegations	· unregistered securities · unregistered agents and/or broker-dealers	· investment contract theory

State	Action	Business	Action Taken	Findings	Securities Law Violations Addressed	Legal Theories Discussed
N.D.	*In re* United Communications Ltd. (Dec. 22, 1993)[634]	not stated	Consent Order Issued	· Summary Order	· unregistered securities · unregistered broker-dealers or salesmen	· investment contract theory
N.D.	*In re* Parkersburg Wireless, LLC (Feb. 4, 1994) [North Dakota Parkersburg Action]	not stated	Cease and Desist Order Issued	· Summary Order	· unregistered securities	· no legal theory addressed, summary conclusions stated
Pa.	*In re* Parkersburg Wireless, LLC, No. 9403-11, 1994 WL 125846 (Pa. Sec. Comm'n) (Apr. 6, 1994) [Pennsylvania Parkersburg Action]	wireless cable television system	Summary Cease and Desist Order Issued	· Summary Order, with stated findings and conclusions	· unregistered securities · unregistered broker-dealer	· investment contract theory
S.D.	*In re* Parkersburg Wireless, LLC (Mar. 28, 1994)[635] [South Dakota Parkersburg Action]	wireless cable television system	Order to Cease, Desist and Refrain Issued	· Summary Order, with stated findings and conclusions	· unregistered securities	· investment contract theory
Wash.	*In re* Express Communications, Inc., No. 94-03-0018, 1995 WL 307000 (Wash. Sec. Div.) (May 2, 1995) [Washington Express Action]	telecommunications systems	Summary Cease and Desist Order Issued	· Summary Order, with stated findings and conclusions	· unregistered securities · unregistered brokers · antifraud violations	· investment contract theory
Wash.	*In re* Dallas MobileComm L.C., No. 94-03-0018, 1995 WL 431589 (Wash. Sec. Div.) (July 10, 1995)	mobile radio system	Consent Order	· Consent Order, with findings of fact and conclusions of law	· unregistered securities · antifraud violations	· investment contract theory · risk capital theory
Wash.	*In re* Third Mobile Ltd. of Las Vegas, No. 94-03-0018, 1996 WL 28692 (Wash. Sec. Div.) (Jan. 18, 1996)	mobile radio system	Consent Order	· Consent Order, with findings of fact and conclusions of law	· unregistered securities · antifraud violations	· investment contract theory · risk capital theory

[634] The Consent Order for the North Dakota case *In re* United Communications Ltd. is attached as Exhibit 9 to an order issued by the Colorado District Court in Feigin v. Infotech Group, Inc., No. 94 CV 1756, 1994 Colo. Sec. LEXIS 1 (Apr. 8, 1994).

[635] The Order to Cease and Desist for the South Dakota case *In re* Parkersburg Wireless, LLC is attached as Exhibit 10 to an order issued by the Colorado District Court in Feigin v. Infotech Group, Inc., No. 94 CV 1756, 1994 Colo. Sec. LEXIS 1 (Apr. 8, 1994).

State	Action	Business	Action Taken	Findings	Securities Law Violations Addressed	Legal Theories Discussed
Wis.	*In re* Knoxville Limited Liability Company, No. X-94044(E), 1994 WL 424373 (Wis. Comm'r Sec.) (Aug. 4, 1994)	wireless cable television system	Summary Order of Prohibition Issued	· Summary Order, based on state allegations	· unregistered securities · unregistered agent	· investment contract theory
Wis.	*In re* Baton Rouge Wireless Cable Television Co., No. X-93078(E), 1994 WL 361581 (Wis. Comm'r Sec.) (June 24, 1994)	wireless cable television system	Summary Order of Prohibition Issued	· Summary Order, based on state allegations	· unregistered securities · unregistered agent and broker-dealers	· investment contract theory
Wis.	*In re* Windgate Fund LLC, No. S-95120(EX), 1995 WL 561541 (Wis. Comm'r Sec.) (Aug. 2, 1995)	not stated	Summary Order of Prohibition Issued	· Summary Order, based on state allegations	· unregistered securities · unregistered agent · antifraud violations	· WIS. STAT. ANN. § 551.02(13) which defines certain LLC interests as securities · WIS. ADMIN. CODE § 1.02(6) which defines investment contract

TABLE II: SUMMARY OF STATE STATUTES EXPRESSLY ADDRESSING WHETHER LLC INTERESTS ARE SECURITIES

State	Statutory Citation	Summary	Statutory Language
Alaska	ALASKA STAT. § 45.55.990(12) (1994)	LLC expressly included in list of interests that are securities	"[S]ecurity" means . . . a limited liability company interest under [title 10, chapter 50 of the Alaska Statutes]*
Cal.	CAL. CORP. CODE § 25019 (West Supp. 1995)	security, unless all members are actively engaged in management	"Security" means any . . . interest in a limited liability company and any class or series of such interests (including any fractional or other interest in such interest), except a membership interest in a limited liability company in which the person claiming this exemption can prove that all of the members are actively engaged in the management of the limited liability company; provided that evidence that members vote or have the right to vote, or the right to information concerning the business and affairs of the limited liability company, or the right to participate in management, shall not establish, without more, that all members are actively engaged in the management of the limited liability company . . . .*
Ga.	GA. CODE ANN. § 14-11-1107(n) (1994)	do not construe as not a security	Nothing in this chapter shall be construed as establishing that a limited liability company interest is not a "security". . . .
Ind.	IND. CODE ANN. § 23-2-1-1(k) (West 1995)	security, unless all members are actively engaged in management	"Security" means . . . an interest in a limited liability company and any class or series of an interest in a limited liability company (including any fractional or other interest in an interest in a limited liability company) . . . . "Security" does not include . . . an interest in a limited liability company if the person claiming that the interest is not a security can prove that all of the members of the limited liability company are actively engaged in the management of the limited liability company.*
Mich.	MICH. COMP. LAWS ANN. § 450.5103 (West Supp. 1995)	security to the same extent as interest in corporation, partnership, or limited partnership	An interest in a limited liability company to which this act applies is a security to the same extent as an interest in a corporation, partnership, or limited partnership is a security.
Mo.	MO. ANN. STAT. § 347.185 (Vernon Supp. 1995)	rebuttable presumption, not a security, if management is not vested in one or more managers	It shall be rebuttably presumed that a member's interest in a limited liability company in which management is not vested in one or more managers is not a security for purposes of any and all laws of this state regulating the sale or exchange of securities.

* The definitional section of these state securities acts begin with the qualification that the definitions in this act, chapter, or part apply "unless the context otherwise requires." ALASKA STAT. § 45.55.990 (1994); CAL. CORP. CODE § 25001 (West 1977); IND. CODE ANN. § 23-2-1-1 (West 1995); PA. STAT. ANN. tit. 70, § 1-102 (Supp. 1995); WIS. STAT. ANN. § 551.02 (West Supp. 1995).

State	Statutory Citation	Summary	Statutory Language
N.M.	N.M. STAT. ANN. § 58-13B-2(V) (Michie Supp. 1995)	security, unless the context requires otherwise	[U]nless the context requires otherwise, "security" means . . . any interest in a limited liability company . . . .
Ohio	OHIO REV. CODE ANN. § 1707.01(B) (Baldwin Supp. 1995)	LLC expressly included in list of interests that are securities	"Security" means any . . . membership interest in limited liability companies . . . .
Pa.	PA. STAT. ANN. tit. 70, § 1-102(t) (Supp. 1995)	security, unless specified conditions satisfied	"Security" means any . . . membership interest in a limited liability company of any class or series, including any fractional or other interest in such interest unless excluded by clause (v) . . . . "Security" does not include . . . (v) A membership interest in a limited liability company where all of the following conditions are satisfied: (A) The membership interest is in a company that is not managed by managers; (B) The purchaser of the membership interest enters into a written commitment to be engaged actively and directly in the management of the company; and (C) The purchaser of the membership interest, in fact, does participate actively and directly in the management of the company.*
Vt.	VT. STAT. ANN. tit. 9, § 4202a(14) (Supp. 1995)	LLC expressly included in list of interests that are securities	"Security" includes . . . any membership interest in a limited liability company . . . .
Wis.	WIS. STAT. ANN. § 183.1303 (West Supp. 1995)	may be a security	An interest in a limited liability company may be a "security". . . .
Wis.	WIS. STAT. ANN. § 551.02(13)(c) (West Supp. 1995)	security presumed, if manager or more than 35 members	"Security" is presumed to include an interest in a limited liability company [organized under Wisconsin law] if the right to manage the limited liability company is vested in one or more managers or if the aggregate number of members of the limited liability company, after the interest is sold, exceeds 35. "Security" is not presumed to include an interest in a limited liability company [organized under Wisconsin law] if the aggregate number of members of the limited liability company, after the interest is sold, does not exceed 35 and the right to manage the limited liability company is vested in its members.*

* The definitional section of these state securities acts begin with the qualification that the definitions in this act, chapter, or part apply "unless the context otherwise requires." ALASKA STAT. § 45.55.990 (1994); CAL. CORP. CODE § 25001 (West 1977); IND. CODE ANN. § 23-2-1-1 (West 1995); PA. STAT. ANN. tit. 70, § 1-102 (Supp. 1995); WIS. STAT. ANN. § 551.02 (West Supp. 1995).

State	Statutory Citation	Summary	Statutory Language
Wis.	WIS. STAT. ANN. § 551.02(13)(b) (West Supp. 1995).	not a security, if 15 or less members and right to manage is vested in members	"Security" does not include . . . any interest in a limited liability company [organized under Wisconsin law] if the aggregate number of members of the limited liability company, after the interest is transferred, does not exceed 15 and the right to manage the limited liability company is vested in its members.*

* The definitional section of these state securities acts begin with the qualification that the definitions in this act, chapter, or part apply "unless the context otherwise requires." ALASKA STAT. § 45.55.990 (1994); CAL. CORP. CODE § 25001 (West 1977); IND. CODE ANN. § 23-2-1-1 (West 1995); PA. STAT. ANN. tit. 70, § 1-102 (Supp. 1995); WIS. STAT. ANN. § 551.02 (West Supp. 1995).

TABLE III: SUMMARY OF STATE POLICY STATEMENTS, INTERPRETIVE OPINIONS, AND NO-ACTION LETTERS RELATING TO LLC INTERESTS AS SECURITIES[636]

State	Administrative Opinion	Legal Theories Discussed	Summary of Findings
Ark.	No-action Letter, Pro Pick LLC (Ark. Sec. Dep't) (Feb. 15, 1994)	· none	The Arkansas Securities Department stated that it would take no action to enforce registration provisions with respect to LLC interests in Pro Pick LLC, where: (1) the LLC had seven members; (2) the LLC was member-managed; (3) each member had one vote, and all members would vote on business matters; and (4) all of the members would be "actively engaged in making significant business decisions."
Conn.	Limited liability company interpretative release, 1A Blue Sky L. Rep. (CCH) ¶ 14,562 (Conn. Aug. 24, 1994)	· investment contract theory	Connecticut Department of Banking stated that it intends to undertake a case-by-case analysis applying the *Howey* investment contract test and focusing on the degree to which members participate in the management and operational decisions of the entity. The Department ordinarily will presume interests in a "manager-member" form of LLC are securities. The Department intends to apply the *Williamson* analysis to interests in a "member-member" form of LLC. The Department cautions it will not merely look at the organizational documents, but it will also consider the economic realities and the actual functions and expertise of those involved in the operation of the entity.
Ind.	Statement of Policy on classification of limited liability company interests as securities, 1A Blue Sky L. Rep. (CCH) ¶ 24,681 (Ind. Sept. 20, 1993)	· investment contract theory	After applying an investment contract analysis, specifically partnership case law, the Indiana Securities Division will focus on two issues: (1) whether the members of the LLC have the right to participate significantly in management, and (2) if they do, whether they have the ability, knowledge and skill necessary to exercise that authority in a meaningful way. If the answer to either of these questions is no, the LLC interest would be a security (assuming the other elements of an investment contract are present).
Kan.	Interpretive Opinion Orchards Drug, L.C., 1991 WL 101804 (Kan. Sec. Comm'r) (May 1, 1991)	· investment contract theory · characteristics of stock test[637]	After applying the *Howey* test for investment contract, the Kansas Securities Commissioner concludes that if members elect managing members on an annual basis, who manage the business affairs of the LLC on an ongoing basis or otherwise delegate management authority to a select group, the LLC interest would be a security.
Me.	Exemption of offers and sales, 2 Blue Sky L. Rep. (CCH) ¶ 29,432 (Me. Jan. 8, 1995)	· none	Rule of the Securities Division of the Maine Bureau of Banking exempts from state registration requirements certain small LLC issuers organized under Maine law or having their principal executive offices in Maine.

[636] Table III does not purport to be a complete listing of all state administrative opinions relating to LLC interests as securities. *See supra* notes 13 and 84.

[637] Commissioner considered, but then rejected, the characteristics of stock test.

State	Administrative Opinion	Legal Theories Discussed	Summary of Findings
Md.	Exemption request—Whether membership interests in a limited liability company are required to be registered, 2 Blue Sky L. Rep. (CCH) ¶ 30,579 (Md. Sec. Comm'r) (Apr. 25, 1994); *see also* Anne Arundel Physicians' Cooperative LLC, 1994 WL 385059 (Md. Sec. Div.) (Mar. 8, 1994).	· investment contract theory[638] · characteristics of stock test[639]	The Maryland Division of Securities stated that it would take no action to require registration of the membership interests in an LLC formed under the Maryland LLC Act where one to two hundred physicians would become members and render physician services on behalf of the LLC.
Md.	770 Lexington Assocs. L.L.C., 1995 WL 535160 (Md. Sec. Comm'r) (June 8, 1995)	· none	In response to a request for an interpretative opinion, the Maryland Division of Securities stated that it would take no action to require the registration of securities issued by the LLC in connection with a commercial real estate venture. The Division, however, stated that it did not concur with claims that the proposed transaction did not involve the offer or sale of a security.
Mich.	Exemption for professional limited liability companies, 2 Blue Sky L. Rep. (CCH) ¶ 32,630 (Mich. Mar. 24, 1994); *see also* Oakland Physician Network, L.L.C., No. 500817, 1994 Mich. Sec. LEXIS 1 (Mich. Dep't of Comm., Corp. & Sec. Bureau) (Jan. 12, 1994)	· none	Order states the offer and sale of interests in a limited liability company may constitute the offer and sale of a security. Exempts from registration, transactions involving the offer and sale of LLC interests in professional limited liability companies formed under the Michigan Limited Liability Company Act to provide the professional services expressly described in the Act, such as services provided by accountants, physicians, architects, engineers and attorneys.
Mich.	Michigan Limited Liability Companies, Release No. 94-2-S, 2 Blue Sky L. Rep. (CCH) ¶ 32,632 (Mich. Corp. and Sec. Bureau) (Jan. 20, 1995)	· none	Release defines how the Michigan Corporations and Securities Bureau will apply the counting provisions in the transactional securities exemption for persons who are members of LLCs.
Minn.	Interpretive Opinion, Lindquist & Vennum Professional Ltd. Liab. Co. (Minn. Dep't Comm.) (Dec. 27, 1993)	· investment contract theory	In response to a request for an interpretive opinion on whether an interest in a proposed professional LLC would be a security, the Minnesota Commissioner of Commerce applied the *Howey* investment contract test and noted that the decision would "ultimately turn on the extent to which the . . . members rely on the efforts of others to generate firm profits."

[638] Theory discussed in LLC's exemption request, but the theory was not addressed in the Maryland Division of Securities' no-action letter. The no-action letter did not state the theory or theories upon which the Maryland Division of Securities based its conclusion.

[639] Theory discussed in LLC's exemption request, but the theory was not addressed in the Maryland Division of Securities' no-action letter. The no-action letter did not state the theory or theories upon which the Maryland Division of Securities based its conclusion.

State	Administrative Opinion	Legal Theories Discussed	Summary of Findings
Mont.	Opinion Letter, H-I Missoula, LLC (Mont. Sec. Dep't) (June 15, 1995)	· investment contract theory	The Montana Securities Department stated that it will treat an LLC as a security if it meets the *Howey* investment contract test. In discussing the reliance on the efforts of others element, the Department stated that it believes a crucial factor in the analysis is the number of LLC members. If the LLC has ten or fewer members, the Department will presume such interests are not securities. This presumption, however, is rebuttable. If the LLC has more than ten members, the Department will review the particular situation to determine whether the members are actively involved in the LLC's business or relying on the efforts of others.
N.C.	Rule .1510, Limited liability company membership interests as securities, 2A Blue Sky L. Rep. (CCH) ¶ 43,474 (N.C. Dec. 1, 1994)	· none	Membership interests in an LLC formed under the North Carolina Limited Liability Company Act shall be presumed to be securities (1) where the articles of organization provide that all members of the LLC are not necessarily managers, or (2) where all members by virtue of their status as members are managers and the number of members is greater than 15. Among the factors that the North Carolina Securities Division will consider as evidence to rebut or support the presumption are: (1) whether investors retain the right to exercise practical and actual control, (2) whether the number of members is so great as to render the managerial powers afforded insignificant and meaningless, (3) whether the promoter has some particular or special skill which is necessary for successful operation, and (4) whether special circumstances render meaningless the managerial powers given to members.
N.J.	Exemption request—Offers of interests in limited liability company, 2 Blue Sky L. Rep. (CCH) ¶ 40,642 (N.J. Bureau of Sec.) (July 27, 1994)	· none	In response to an inquiry as to the applicability of certain exemptions to the offer of interests in an LLC, the New Jersey Bureau of Securities stated LLC interests are considered securities and subject to the New Jersey securities laws. The Bureau went on to find that under the specific facts stated in the inquiry the registration exemptions at issue would apply.
Okla.	Exemption request—Membership interests in a limited liability company, 2A Blue Sky L. Rep. (CCH) ¶ 46,664 (Okla. Dep't of Sec.) (Aug. 28, 1992)	· investment contract theory · risk capital test	In response to a request for a no-action position in connection with the offer and sale of membership interests in an LLC, the Oklahoma Department of Securities applied the *Howey* investment contract test and noted that Oklahoma has adopted the "substantial" approach, rather than the "solely" approach. Further, the Department indicated that in light of Oklahoma case law the Department would consider investor sophistication and dependency, not merely the provisions in the operating documents.
S.C.	Statement of Policy 95-2—Limited liability company membership interest as securities, 2A Blue Sky L. Rep. (CCH) ¶ 51,580 (S.C. Sec. of State and Sec. Comm'r) (June, 1995)	· investment contract theory	The South Carolina Securities Commissioner will require compliance with the South Carolina securities act and will make recommendations about enforcement actions based upon rebuttable presumptions: (1) that membership interests in manager-managed LLCs with any members who are not equally participating managers are securities; and (2) membership interests in member-managed LLCs in which each member has practical and meaningful participation in and control over the managerial decisions of the enterprise are not securities. The Securities Commission also provides "safe harbor" relief for interests in LLCs formed in South Carolina when (1) the articles of organization and operating agreement do not appoint managers or cause members to delegate managerial control, (2) all members retain the right to exercise practical and actual control over managerial decisions, (3) the number of members is not so great as to render members' managerial powers substantially meaningless, (4) the promoter does not have a peculiar or special skill necessary for successful operation, and (5) there are no other special facts or circumstances which render members' managerial powers meaningless.

State	Administrative Opinion	Legal Theories Discussed	Summary of Findings
S.D.	Letter from Debra M. Bollinger, Director, S.D. Div. of Sec., to Hon. Thomas C. Barnett, Executive Director of State Bar of S.D. (May 16, 1995)	· investment contract theory	The South Dakota Division of Securities indicated it would apply the *Howey* investment contract test to determine if an LLC interest was a security. The Division stated that it would look at three elements to determine if the "solely through the efforts of others" element of *Howey* is present: (1) the contractual power of the members to effect management decisions; (2) the actual ability (in practice) to effect management decisions: (a) distance between the investors and the entity, (b) knowledge and/or experience of the members, and/or (c) presence of professional management or management team; and (3) the number and location of the members.
Tenn.	Limited liability company interests as securities, 2A Blue Sky L. Rep. (CCH) ¶ 54,521 (Tenn. Mar. 7, 1995)	· investment contract theory · characteristics of stock test	After discussing *Howey*, *Williamson* and *Landreth*, the Tennessee Securities Division takes the position that an interest in an LLC is a security when: (1) An LLC member invests money or value in a common scheme or enterprise and is led to an expectation of profits through the entrepreneurial or managerial efforts of others in that: (a) some agreement among the LLC members leaves so little power in the hands of the member that the arrangement distributes power as would a limited partnership; or (b) the member is so inexperienced and unknowledgeable about the business of the LLC that he is incapable of intelligently exercising his powers; or (c) the member is so dependent on the unique entrepreneurial or managerial ability of the promoter or manager that the member cannot replace the manager of the enterprise or otherwise exercise meaningful membership powers; or (2) Membership interests are sold to large numbers of the general public, with the result that there are so many members that a membership vote is more like a corporate vote, each member's role having been diluted to the level of a single shareholder in a corporation. The Division also states if an LLC interest possesses the characteristics of stock set forth in *Landreth*, the LLC interest could be labeled stock which under the Tennessee securities act is a security.
Wyo.	Draft Interpretive Opinion Letter, Are Limited Liability Company Memberships Securities? (Wyo. Sec. of State, July 16, 1993)[140]	· investment contract theory	The interpretive opinion letter concludes that LLC membership interests are presumptively not securities, but notes that in certain circumstances they may be deemed "investment contract securities" depending on whether anticipated profits of the enterprise are derived substantially through a third party's efforts. The determination depends not only on the legal control granted to the members by the articles of organization and operating agreement, but on the members' actual ability and opportunity to exercise those powers. Applying the *Williamson* general partnership analysis, the letter states that an LLC interest may be a security if (1) the documents leave the members with no management power similar to a limited partner, or (2) the member is incapable of exercising the powers granted because of limited knowledge or inexperience in business matters, or (3) the members depend on an ability of a manager or promoter that cannot be replaced, or (4) some other factor demonstrates the member's anticipated profit relies "substantially" on another's efforts.

[140] In-house opinion drafted by staff members of the Wyoming Securities Division and not a formal opinion issued by the Wyoming Attorney General's office. The informal opinion was drafted in response to the many inquiries the office received and has not been released as a formal legal opinion.

NOTE:

A PAGE OF HISTORY OR A VOLUME OF LOGIC?: REASSESSING THE SUPREME COURT'S ESTABLISHMENT CLAUSE JURISPRUDENCE

"History is a voice forever sounding across the centuries the laws of right and wrong. Opinions alter, manners change, creeds rise and fall, but the moral law is written on the tablets of eternity."—Froude

"History is bunk."—Henry Ford

I. INTRODUCTION

Justice Holmes once said, "A page of history is worth a volume of logic."[1] Nowhere does that sentiment ring more true than in the context of discerning the proper scope of the Establishment Clause. Unfortunately, since 1947 the Supreme Court has severed the Clause from its historical roots, abandoning the lessons of its poignant historical experiences. The result has proved catastrophic, as the Court's Establishment Clause jurisprudence seems to shift, sometimes drastically, with every personnel change on the Court.[2] Nonetheless, history may be as poor a barometer of the Clause's intended scope as are the Court's inconsistent decisions. Indeed, the history of the Establishment Clause is not only confusing, but mired in minutiae and readily manipulated. Unwary jurists consistently fall prey to its simple deceptiveness and overlook its unquantifiable complexity. The ominous result is an Establishment Clause jurisprudence which is one-sided and distorted, a jurisprudence without substance and historical support.

The Establishment Clause prohibits Congress from making any law "respecting an establishment of religion."[3] Although the plain language of the Clause would seem to indicate that it proscribed only establishments as they were commonly known to the Framers, i.e., legislative designation of an official state church, courts have read much into the term "respecting" and concluded the Clause's reach is broader than its face suggests.[4] Engaged in an inherent (and necessary) conflict with the Establishment Clause is the Free Exercise Clause, which forbids Congress from enacting any law prohibiting the free exercise of religion.[5]

---

1. New York Trust Co. v. Eisner, 256 U.S. 345, 349 (1921).

2. For an example, see *infra* notes 422-26, 440 and accompanying text, which discuss the impact of Justice O'Connor upon the Court's Establishment Clause jurisprudence.

3. U.S. CONST. amend. I.

4. For an argument suggesting that the plain language approach has been incorrectly and without explanation rejected, see William C. Porth & Robert P. George, *Trimming the Ivy: A Bicentennial Re-Examination of the Establishment Clause*, 90 W. VA. L. REV. 109 (1987).

5. U.S. CONST. amend. I. One author argues that the Religion Clauses "must be construed

Given the breadth and generality of the Clause's language, it is not surprising that many interpretations have been proffered. Nonetheless, most historians and jurists generally adopt one of two views: separationism or nonpreferentialism.[6] Separationism, which is the view most often espoused by the Supreme Court, advocates, as its name suggests, strict separation between church and state.[7] Separationists allege that the Constitution and the Establishment Clause prohibit any and all federal government aid to religion.[8] The competing view of nonpreferentialism in essence proffers that the Framers intended the Establishment Clause to prohibit only congressional establishment of a national church and elevation of one religious sect to a preferred status over other sects.[9] Hence, nonpreferentialism permits government support for religion provided no religions or religious sects are excluded from receipt of the benefit.[10]

This article begins with a brief overview of the Establishment Clause's adoption and the writings of James Madison and Thomas Jefferson, the two figureheads upon which the Supreme Court most regularly relies to support its decisions and its endorsement of separationism. Specifically, the article examines Madison's *Memorial and Remonstrance* and Jefferson's Danbury letter and Virginia Bill for Religious Freedom. Following this discussion, the article briefly outlines the rise of the *Lemon* test, the traditional standard developed by the Court to resolve Establishment Clause disputes. It then traces the Supreme Court's Establishment Clause jurisprudence and examines its two most recent pronouncements: *Rosenberger v. Rector & Visitors of the University of Virginia*[11] and *Capitol Square Review & Advisory Board v. Pinette*.[12] Finally, the article evaluates the merits and historical accuracy of the Court's Establishment Clause jurisprudence. In this respect, it concludes that the Court's decisions in this area, and the test on which those decisions are based, are riddled with historical inaccuracies. These inaccuracies include the Court's gross overemphasis on, and misunderstanding of, the individual church-state viewpoints of both Thomas Jefferson and James Madison.[13] Not only has the

---

as never in contradiction." Carl H. Esbeck, *A Restatement of the Supreme Court's Law of Religious Freedom: Coherence, Conflict, or Chaos?*, 70 NOTRE DAME L. REV. 581, 594 (1995). This assertion ignores, however, that the Clauses frequently *must* be in conflict—they protect different interests and seek conflicting objectives. The Establishment Clause limits the state's involvement in religion while the Free Exercise Clause protects religious expression. Therefore, whenever religious expression is curtailed by the Establishment Clause, the two are in contradiction.

6. For an interesting debate regarding the merits of each view, see Robert L. Cord & Howard Ball, *The Separation of Church and State: A Debate*, 1987 UTAH L. REV. 895.

7. Note that even the Court has not gone so far as to say all aid, even that which is incidental, is restricted. As will be shown, however, the Court's tendencies have historically leaned far more to the separationist side than any other.

8. ROBERT L. CORD, SEPARATION OF CHURCH AND STATE: HISTORICAL FACT AND CURRENT FICTION 19 (1982).

9. LEONARD W. LEVY, THE ESTABLISHMENT CLAUSE 112-13 (1994).

10. For an interesting historical overview of the tension between nonpreferentialists and strict-separationists, see John Witte, Jr., *The Theology and Politics of the First Amendment Religion Clauses: A Bicentennial Essay*, 40 EMORY L.J. 489 (1991).

11. 115 S. Ct. 2510 (1995).

12. 115 S. Ct. 2440 (1995).

13. For discussions of Madison and Jefferson, see *infra* notes 40-63, 462-94 and accompanying text.

Court characterized Jefferson and Madison as indisputably separationist, it has further attributed their views to every Framer of the Bill of Rights and found the concept of separationism to be inherent in the Clause itself.[14] As such, the Court has ignored and belittled the views of virtually every person involved in the framing of the Establishment Clause. The Court further ignored history when it incorporated the Clause and subsequently applied it to the states via the Fourteenth Amendment.[15] This incorporation dramatically altered the federalist structure the Framer's intended to inhere in the Clause and has resulted in chaos, as the Court has been forced to engage in a number of roles for which it is ill-suited. These roles include Court micromanagement of religious issues in public schools,[16] Court decisions as to the amount and types of aid states may render to private religious schools,[17] and a host of other local and regional issues the Framers intended the states, rather than the national government, to resolve. As such, this author posits that the Court should return the vast majority of those decisions to the states, and allow local citizens to make these delicate and sensitive determinations.[18]

II. ADOPTING THE AMENDMENT

It was to fulfill a campaign promise that Madison stood on June 8, 1789, to address the First Congress and introduce preliminary versions of the Religion Clauses.[19] His first proposal read: "The civil rights of none shall be abridged on account of religious belief or worship, nor shall any national religion be established, nor shall the full and equal rights of conscience be in any manner, or on any pretext, infringed."[20] Not to be hurried, the House referred Madison's proposals to committee, where they remained until the House debates of August 15.[21] During this time, the committee, which included Madison, altered the amendment to read as follows: "No religion shall be established by law, nor shall the equal rights of conscience be infringed."[22] The rewording was not complete, however, for, again on August 15, the House adopted by a 31-20 vote a version stating, "Congress shall make no laws touching religion, or infringing the rights of conscience."[23] The final changes came on August 20, when the House at long last settled on the following wording and submitted this amendment to the Senate: "Congress shall

14. *See infra* notes 79-81 and accompanying text.

15. For a discussion and critique of this incorporation, see *infra* notes 77-78, 508-28 and accompanying text.

16. For a discussion of the public education cases, see *infra* notes 170-275 and accompanying text; for a critique of those decisions, see *infra* notes 449-61 and accompanying text.

17. For a discussion of the aid to parochial school cases, see *infra* notes 73-169 and accompanying text; for an analysis of those decisions, see *infra* notes 444-48 and accompanying text.

18. *See infra* notes 508-28 and accompanying text.

19. ARLIN M. ADAMS & CHARLES J. EMMERICH, A NATION DEDICATED TO RELIGIOUS LIBERTY: THE CONSTITUTIONAL HERITAGE OF THE RELIGION CLAUSES 17 (1990).

20. *Id.*; CORD, *supra* note 8, at 7; LEVY, *supra* note 9, at 95.

21. ADAMS & EMMERICH, *supra* note 19, at 17.

22. *Id.*; LEVY, *supra* note 9, at 96.

23. ADAMS & EMMERICH, *supra* note 19, at 18; LEVY, *supra* note 9, at 101.

make no law establishing religion, or to prevent the free exercise thereof, or to infringe the rights of conscience."[24]

Much debate has centered around the significance of the House's use of language in these various proposals. In short, the evidence is insufficient to assert confidently either that the changes were made in response to simple stylistic differences or were meant to embody substantive variations in the meaning of the proposals themselves.[25] Recall that the amendment first before the floor that day read: "No religion shall be established by law, nor shall the equal rights of conscience be infringed." This proposal spawned a variety of reactions, ranging from fear that it would "abolish religion altogether,"[26] to doubt that it was necessary at all.[27] Without expressing an opinion as to the amendment's utility, Madison believed it necessary to calm those who in the State Conventions feared that Congress would act under the Necessary and Proper Clause to establish a national religion or infringe the rights of conscience.[28] He therefore furthered a version which on its face prevented Congress from establishing a national religion.[29] The use of "national," however, met resistance because it implied that "this [a national] form of Government consolidated the Union" and thereby invaded those rights reserved to the states.[30] Although Madison disagreed, he did not press the motion further.[31] Representative Livermore noted his discontent with the amendment as written and proposed the version temporarily adopted.[32]

No comparable records of the Senate's debate, which began on September 3, exist. Because of the debate's secret nature the record notes only that the Senate considered and dismissed three motions.[33] These read as follows: First, "Congress shall make no law establishing one religious sect or society in preference to others"; second, "Congress shall not make any law infringing the rights of conscience, or establishing any religious sect or society"; and third, "Congress shall make no law establishing any particular denomination of

24. ADAMS & EMMERICH, *supra* note 19, at 18; LEVY, *supra* note 9, at 101.

25. Nonetheless, the scant legislative history suggests most members participating in the House debate concerned themselves primarily, if not exclusively, with two objectives: protecting the rights of conscience, or religious freedom in the form of religious choice, and alleviating fears that Congress could create, or establish, a national religion. Commentators are in virtual consensus that these were fundamental, legitimate fears which the Framers meant to address in the Religion Clauses. The point of contention, however, is whether the Framers intended the Clauses to encompass *only* these apprehensions. Certainly, some weight must be accorded the fact that Madison directed all his comments to free exercise and formal establishments. Even Representative Gerry, who opposed use of the term national, did so not out of any opposition to the term's inherent concept or because he considered the amendment's reach to extend beyond prohibition of a national church, but rather because he feared an Antifederalist backlash. LEVY, *supra* note 9, at 98-99.

26. *Id.* at 97.

27. *Id.*

28. ADAMS & EMMERICH, *supra* note 19, at 17; CORD, *supra* note 8, at 9; LEVY, *supra* note 9, at 97.

29. ADAMS & EMMERICH, *supra* note 19, at 17; LEVY, *supra* note 9, at 98.

30. ADAMS & EMMERICH, *supra* note 19, at 18.

31. *Id.*; LEVY, *supra* note 9, at 99.

32. LEVY, *supra* note 9, at 98.

33. *Id.* at 102.

religion in preference to another."[34] Unable to agree on any of these three proposals, the Senate that day adopted a proposal which included the simple statement, "Congress shall make no law establishing religion."[35] Following the House's example of indecisiveness, however, the Senate returned six days later to pass its final version: "Congress shall make no law establishing articles of faith or a mode of worship, or prohibiting the free exercise of religion."[36]

The House rejected the Senate's proposed amendments, and in an attempt at reconciliation suggested a joint committee.[37] This committee formulated the following proposal: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof."[38] On September 25, the Senate approved this wording, and with it the Religion Clauses.[39]

III. MADISON AND JEFFERSON

Unfortunately, the men who framed the First Amendment did not explain, at least in detail, what actions they collectively believed the Establishment Clause encompassed. Although undoubtedly all the Framers believed the Clause prohibited the formal establishment of a national religion, it is not clear what, if any, other actions beyond formal establishment the Clause restricted.[40] Nonetheless, courts and commentators have proffered various constructions.[41] None of these constructions, however, has been so hotly debated or yielded such dramatic results as the one proffered by the Supreme Court in 1947 in *Everson v. Board of Education*.[42] There, the Court not only unanimously endorsed separationism, but based its decision exclusively on the views, acts, and writings of James Madison and Thomas Jefferson.[43] The Court did so despite the fact that Jefferson did not even participate in the framing, adoption, and ratification of the Establishment Clause and that Madison was only one of many Framers.[44] Given the Court's continuing propensity to frame its historical dialogues in terms of Madison's and Jefferson's church-state jurisprudence, the following discussion describes those writings which the Court consistently relies upon.

---

34. *Id.*

35. *Id.*

36. ADAMS & EMMERICH, *supra* note 19, at 18; CORD, *supra* note 8, at 9.

37. ADAMS & EMMERICH, *supra* note 19, at 18; CORD, *supra* note 8, at 9; LEVY, *supra* note 9, at 103.

38. LEVY, *supra* note 9, at 103-04.

39. *Id.* at 104.

40. STEVEN D. SMITH, FOREORDAINED FAILURE: THE QUEST FOR A CONSTITUTIONAL PRINCIPLE OF RELIGIOUS FREEDOMS 18-19 (1995).

41. *Compare* the separationist view of Leonard Levy, *supra* note 9, *with* the nonpreferentialist view of Robert Cord, *supra* note 8.

42. 330 U.S. 1 (1947).

43. *Everson*, 330 U.S. at 8-14. For a discussion of *Everson*, see *infra* notes 73-89 and accompanying text.

44. For a critique of the Court's overemphasis of Madison and Jefferson in its decisions, see *infra* notes 462-506 and accompanying text.

A. *Madison's* Remonstrance

In the annals of Religion Clause jurisprudence, history reserves only Jefferson a pedestal so high as Madison, who was not only the fourth President of the United States, but also a ratifier, and in essence the creator, of the Bill of Rights. One of Madison's earliest encounters with religion and government came in 1785, when in response to a proposed Virginia bill attempting to impose a tax on Virginia property owners to support Christian teachers, he authored a tract entitled "Memorial and Remonstrance Against Religious Assessments, 1785."[45] In this *Remonstrance*, Madison proffered fifteen arguments against passage of the bill. Primary among these was the importance of free exercise of religious conscience.[46] To this end, Madison wrote, "It is the duty of every man to render to the Creator such homage, and such only, as he believes to be acceptable to him."[47] Madison further stated that the legislature was without such authority as to enact the bill.[48] If society lacked any authority over religion, it was axiomatic that society's appointed representatives could exercise no such influence; to do so was tyrannical.[49] Finally, Madison was concerned with the proven historical pattern that ecclesiastical establishments tainted and corrupted religion.[50]

Undoubtedly, the *Remonstrance* sheds light on Madison's position regarding church and state. Without question, he opposed any taxes or other coercive payments the proceeds of which specifically and exclusively supported any one religion or religious endeavor.[51] Indeed, the *Remonstrance* focused upon the dangers of exalting one sect or one religion over all others. The *Remonstrance* did more, however, than simply address establishments. It grounded the right to free exercise of religion in natural law, indicating the paramount reverence Madison accorded religious freedom.[52] For Madison, protection of these liberties entailed casting the church and the national government into mutually exclusive spheres and forbidding each from encroaching on the other's appointed domain.

B. *Jefferson's Danbury Letter and Virginia Bill for Religious Freedom*

Undoubtedly, Thomas Jefferson's metaphor that the Establishment Clause erects a wall of separation between church and state is the most quoted statement in the annals of Establishment Clause jurisprudence.[53] Notwithstanding

---

45. James Madison, *Memorial and Remonstrance Against Religious Assessments, 1785*, *reprinted in* CORD, *supra* note 8, at 244-49; *see also* ADAMS & EMMERICH, *supra* note 19, at 12; ANSON P. STOKES & LEO PFEFFER, CHURCH AND STATE IN THE UNITED STATES 55 (1964).

46. CORD, *supra* note 8, at 244.

47. ADAMS & EMMERICH, *supra* note 19, at 12; CORD, *supra* note 8, at 244; STOKES & PFEFFER, *supra* note 45, at 56.

48. CORD, *supra* note 8, at 245.

49. *Id.* ("Because if religion be exempt from the authority of the Society at large, still less can it be subject to that of the Legislative Body . . . . The Rulers who are guilty of such an encroachment, exceed the commission from which they derive their authority, and are Tyrants.").

50. *Id.* at 246.

51. ADAMS & EMMERICH, *supra* note 19, at 12; CORD, *supra* note 8, at 246.

52. CORD, *supra* note 8, at 246.

53. Interestingly, Jefferson was not the original author of the metaphor. That credit belongs

this fame, the metaphor's actual utility as an indicator of Jefferson's intent is limited.[54] The letter in which the phrase appears, an 1802 response to the Danbury Baptist Association, neither offers any explanation of what exactly this wall is nor any discussion of whether it is absolute.[55] That Jefferson, in using this metaphor, intended the wall to sever completely government and religion is at best untenable, at least, insupportable. This does not suggest, however, that Jefferson did not advocate a rigid separation, but that such tendencies are best developed by other evidence.

It is not Jefferson's Danbury letter, but rather his renowned proposal entitled "A Bill for Establishing Religious Freedom" that demonstrates Jefferson's insights regarding religious liberty. One historian has gone so far as to proclaim the bill "the most important document in American history, bar none."[56] Despite its modern repute, the bill's path to enactment was a long and storied one.

Introduced in the Virginia legislature in 1779, it proved too radical and thus was not enacted until 1786.[57] In the interim, the general assessment controversy diverted all of Jefferson's and Madison's attention from the Bill, as they found themselves locked in a fierce struggle[58] with those seeking to institute a tax which undoubtedly curtailed religious liberty. Indeed, it was this assessment controversy which led to Madison's *Remonstrance*. Once Jefferson and Madison orchestrated the assessment's defeat in 1785, both returned their attention to Jefferson's Bill, which finally passed on January 19, 1786.[59]

The Bill began with a sparkling preamble emphasizing the gravity of religious freedoms. There, Jefferson stated, "Almighty God hath created the mind free, and manifested his supreme will that free it shall remain, by making it altogether insusceptible of restraint."[60] In addition, Jefferson con-

---

to Roger Williams, who wrote in 1644 that when a religion "ha[s] opened a gap in the hedge or wall of separation between the garden of the Church and the wilderness of the world, God hath ever broke down the wall itself, removed the candlestick, etc., and made his garden a wilderness, as at this day." ADAMS & EMMERICH, *supra* note 19, at 5-6; *see also* STOKES & PFEFFER, *supra* note 45, at 52 (discussing Roger Williams's contributions to the religious freedom debates and influence upon Thomas Jefferson).

54. Consider the following remarks Chief Justice Rehnquist leveled at "the wall" in 1985: "It is impossible to build sound constitutional doctrine upon a mistaken understanding of constitutional history, but unfortunately the Establishment Clause has been expressly freighted with Jefferson's misleading metaphor for nearly 40 years." Wallace v. Jaffree, 472 U.S. 38, 92 (1985) (Rehnquist, J., dissenting).

55. For a reproduction of Jefferson's letter, see CORD, *supra* note 8, at 112-13.

56. Daniel L. Dreisbach, *Thomas Jefferson and Bills Number 82-86 of the Revision of the Laws of Virginia, 1776-1786: New Light on the Jeffersonian Model of Church-State Relations*, 69 N.C. L. REV. 159, 160 (1990) (quoting Harvard historian Bernard Bailyn).

57. STOKES & PFEFFER, *supra* note 45, at 52; Dreisbach, *supra* note 56, at 163-64.

58. Fearful of the unexpectedly strong support for the assessment, which was sponsored by Patrick Henry, Jefferson disclosed to Madison a possible course of action: "What we have to do I think is devoutly to pray for his [Henry's] death." Dreisbach, *supra* note 56, at 166. As Dreisbach notes, however, Madison had a much more sensible solution: have Henry elected Governor so as to remove him and his influence from the state's legislative body. *Id.* In the end, Madison won out and Henry was elected Governor. *Id.*

59. ADAMS & EMMERICH, *supra* note 19, at 12; Dreisbach, *supra* note 56, at 169 n.60.

60. Thomas Jefferson, A Bill for Establishing Religious Freedom, 1785, *in* ADAMS & EMMERICH, *supra* note 19, at 110 (emphasis omitted).

demned forced contributions for the propagation of religion, and staunchly characterized the opinions of humanity as beyond the jurisdiction of the civil government.[61] Also prohibited under the Bill were government compulsions upon the citizenry to frequent or support religious institutions.[62] Not surprisingly, the idea expressed in the Bill's conclusion parallels that in Madison's *Remonstrance*—that free exercise rights emanate from natural law and cannot be compromised by governmental coercion or persecution.[63] Noticeably, the Bill failed to mention any restriction on religious establishments.

IV. THE CLAUSE AND THE COURT: A HISTORY

A. *Introduction*

Between the ratification of the Establishment Clause and 1947, the Supreme Court rendered few Establishment Clause decisions, and thus had no cause to develop a comprehensive framework for resolving Establishment Clause disputes. Of the few Establishment Clause decisions actually made, none were meaningful or contrary to the understood meaning of the Clause: the national government could not establish religions, but state governments were free to legislate on the subject.[64] Given this understanding, it is natural that few conflicts over the Clause's scope occurred. In the late 1800s and early 1900s, however, the movement to apply the provisions of the Bill of Rights to the states gained momentum.[65] As such, it was inevitable that the debate would arise over whether the Establishment Clause should, or would, apply to the states via the Fourteenth Amendment. Beginning with *Everson*, which is discussed immediately below, the Supreme Court's answer to that question was a resounding yes. With the application of the Establishment Clause to the states, however, a new host of problems developed. These problems included the extent to which the Clause would apply to the states and the degree to which existing state institutions, legislation, and practices would be altered by that application.

Incorporation created an additional, and significant, difficulty—how to construe the Clause so as to ensure its consistent application. From 1947 to 1971, the Court searched for a malleable yet effective framework. During this period, it decided cases based mostly upon its own intuitions of those actions it collectively believed the Clause was intended to prohibit. Not surprisingly, the result was a jurisprudence without much consistency. In 1971, however, the Supreme Court in *Lemon v. Kurtzman*[66] established a three part test for use in resolving Establishment Clause issues.[67] Although the Court had de-

61. *Id.* at 110-12.
62. *Id.* at 111.
63. *Id.* at 112.
64. SMITH, *supra* note 40, at 18.
65. CORD, *supra* note 8, at 93-101; SMITH, *supra* note 40, at 51.
66. 403 U.S. 602 (1971).
67. For a discussion of *Lemon*, see *infra* notes 112-26 and accompanying text. The Court in *Lemon* prohibited cash subsidies to parochial school teachers because the authorizing statutes excessively entangled the state governments of New York and Rhode Island with religion. *Lemon*,

lineated each of the factors in previous decisions, *Lemon* marked the first time the Court combined the factors to form a comprehensive framework. To be valid under that new framework, a statute must have a secular legislative purpose, must have a principal or primary effect which neither advances nor inhibits religion, and must not foster an excessive government entanglement with religion.[68] A determination of excessive entanglement consists of "examin[ing] the character and the purposes of the institutions that are benefitted, the nature of the Aid that the State provides, and the resulting relationship between the government and the religious authority."[69]

Oddly enough, the line of cases subsequent to the creation of the *Lemon* framework has proved no more consistent than the cases decided before the test's existence.[70] Indeed, nearly twenty-five years after *Lemon*, the Court continues to struggle with the seemingly insurmountable issue of how to define the scope of the Establishment Clause and articulate its prohibitions into a workable framework. It appears that the Court has conceded that the *Lemon* articulation is not that framework.[71] Although not authoritatively disposed of, the Court has not applied the test in any Establishment Clause decision since 1993.[72]

The discussion that follows demonstrates the struggle faced by the Supreme Court in its search for a standard. As will be shown, the Court's opinions reflect a collective failure on the part of the Justices from 1947 to the present to agree on the mandates inherent in the Establishment Clause. This dilemma is reflected in the Court's decisions, whether in the private or public educational sphere, or the areas of higher education and religious symbols.

B. *Education and the Establishment Clause*

A vast majority of the Establishment Clause cases before the Court concern education. In particular, disputes implicating public education arise with alarming frequency. For example, issues before the Court on a regular basis have included—and continue to include—the constitutionality of school prayer, Bible reading in classrooms, creationism, and the so-called "released time" programs. Aid to private religious schools, and parochial schools in particular, has also stirred much debate. In fact, it was a dispute over parochial school aid from public generated funds which embarked the Court on the road to the confusion now abundant in its Establishment Clause jurisprudence.

---

403 U.S. at 612-13.

68. *Id.*

69. *Id.* at 615.

70. *Compare* the pre-*Lemon* instructional materials turmoil, *infra* notes 90-111 and accompanying text, *with Lemon* itself and the post-*Lemon* chaos regarding the cash subsidies cases, *infra* notes 112-49 and accompanying text.

71. For a discussion of the *Lemon* test's demise, see *infra* notes 416-43 and accompanying text.

72. *See infra* notes 432-35 and accompanying text.

1. Aid to Parochial Schools

a. Everson *and the Beginning*

The Court's first Establishment Clause decision of the modern era was its 1947 decision in *Everson v. Board of Education*.[73] The substantive issue in *Everson* involved a New Jersey statute which granted local school districts the authority to make rules and enter into contracts for the transportation of schoolchildren to and from school.[74] The statute made no distinction between private and public schools, but rather made accessibility to the aid contingent upon the school not operating for profit.[75] A taxpayer challenged the statute because part of the reimbursement went to Catholic parochial school students;[76] hence, the law purportedly constituted a prohibited establishment of religion.

The Court first held that the Fourteenth Amendment's Due Process Clause encompassed the restrictions found in the Establishment Clause.[77] The Establishment Clause thus incorporated, the Court was free to apply it to state and local governmental action, including the New Jersey statute in *Everson*.[78] It then delved into what it perceived to be the Clause's relevant history. In so doing, it turned to Jefferson's Bill for Religious Liberty and Madison's *Remonstrance*.[79] With respect to the Bill for Religious Liberty, the Court boldly stated that the concerns expressed in the Virginia Bill mirrored exactly those enshrined in the Establishment Clause.[80] The Court then invoked Jefferson's wall of separation metaphor as grounds for the no-aid, strict separationist interpretation it adopted.[81] Although it rejected the nonpreferentialist position,

---

73. 330 U.S. 1 (1947).

74. *Everson*, 330 U.S. at 3 n.1.

75. *Id.* This, of course, operated to allow public schools and non-profit private schools access to the aid.

76. *Id.* at 3. One commentator attributes the dispute in *Everson*, at least in part, to the intergroup tensions between Protestants and Catholics which developed in the post-World War II period. RICHARD MORGAN, THE SUPREME COURT AND RELIGION 81 (1972). Morgan posits that during World War II Roman Catholics lost their consciousness of themselves as a minority group, and that once the war was over, Catholics' attempts to exert their own identity and influence their own culture were perceived by Protestants as disturbing and aggressive. *Id.* at 81-82.

77. Although the Court had previously held that the First Amendment applied to the states, Cantwell v. Connecticut, 310 U.S. 296 (1940), it had not until *Everson* explicitly incorporated the Establishment Clause. For a critique of the Court's decision to incorporate the Establishment Clause, see *infra* notes 508-28 and accompanying text.

78. Note that a majority of Supreme Court Justices have never favored "total incorporation," or the incorporation of every right found in the first eight amendments. *See* Note, *Rethinking the Incorporation of the Establishment Clause: A Federalist View*, 105 HARV. L. REV. 1700 (1992) [hereinafter Note]. Rather, the Court has adopted a theory of "selective incorporation," which Justice Cardozo has described as those specific pledges of particular amendments found to be "implicit in the concept of ordered liberty, and thus, through the Fourteenth Amendment, become operative on the states." *Id.* (citing Palko v. Connecticut, 302 U.S. 319 (1937)).

79. *See Everson*, 330 U.S. at 8-14.

80. *Id.* at 13.

81. *Id.* In the Court's words:

> The "establishment of religion" clause of the First Amendment means at least this: Neither a state nor the Federal Government can set up a church. Neither can pass laws which aid one religion, aid all religions, or prefer one religion over another. Neither can force nor influence a person to go to or to remain away from church against his will or force him to profess a belief or disbelief in any religion. No person can be punished for

the majority found the New Jersey statute constitutional,[82] apparently in part out of fear that to otherwise hold would preclude all religions and religious denominations from receiving, because of their faith, the benefits of public welfare legislation.[83] For the Court, its decision coincided perfectly with the Constitution's mandate that government be neutral with respect to religion. Because the majority characterized the benefit as flowing to the student rather than the school,[84] it had little difficulty finding the requisite governmental indifference. The law, therefore, was not one respecting an establishment of religion.[85]

Justices Jackson and Rutledge each wrote vigorous dissents which agreed with the majority's analytical framework but disagreed with its conclusion. Jackson leapt into an in-depth discussion of Catholic dogma, apparently reading the statute, which was facially neutral, as if it discriminated against all religious schools not Catholic.[86] Moreover, there was no indication that there existed within the school district any not-for-profit private schools of other faiths (or of no faith) that had been denied aid. Hence, Jackson's conclusion that the statute as applied violated the Establishment Clause was unsupported and premature.[87] In contrast, Justice Rutledge characterized Jefferson's Virginia Bill, as well as Jefferson's views on church and state, as inapposite to the majority's conclusion.[88] He also took issue with the majority's assertion that the use of funds was for a public purpose—namely that of education of children.[89]

> entertaining religious beliefs or disbeliefs, for church attendance or non-attendance. No tax in any amount, large or small, can be levied to support any religious activities or institutions, whatever they may be called, or whatever form they may adopt to teach or practice religion. Neither a state nor the Federal Government can, openly or secretly, participate in the affairs of any religious organizations or groups and vice versa. In the words of Jefferson, the clause against establishment of religion by law was intended to erect a "wall of separation between church and state."

Id. at 15-16 (citations omitted).

82. *Id.* at 18.

83. *Id.* at 16.

84. *Id.* at 18.

85. *See id.*

86. *Id.* at 21 (Jackson, J., dissenting).

87. Jackson stated that, "As applied to this taxpayer by the action he complains of, certainly the Act does not authorize reimbursement to those who choose any alternative to the public school except Catholic Church schools." *Id.* The statute did, however, authorize expenditures to any private school whether religious or non-religious, which complied with its terms, i.e., was not operated for profit. If no alternative private schools existed within this specific school district, then Jackson's presumption imposed a burden on the parochial schools which was not only misdirected but also impossible to meet. If no other eligible schools existed, then the Catholic schools should not have been denied aid unless evidence suggested that the statute was created to specifically aid Catholic schools. Jackson mentioned no such evidence.

88. *Id.* at 29 (Rutledge, J., dissenting).

89. *Id.* at 49, 51, 52-53. Under Rutledge's views, however, religious institutions and religious people acting for religious purposes are ineligible to receive the benefits of public aid and social welfare legislation. This constitutes discrimination *against* religion and could potentially chill free exercise rights. Finally, consider that Rutledge's position rings of an unconstitutional condition—to secure a legislatively or constitutionally permitted benefit a person would be required to forego exercising constitutional rights guaranteed under the First Amendment's Free Exercise Clause.

b. *The Post-*Everson *Turmoil: Instructional Materials*

Sixteen long years after its ratification of separationism, the Supreme Court set out to more clearly delineate the bounds within which such schools may receive aid from the public coffers. Anything but clarity, however, resulted from this line of cases. In *Board of Education v. Allen*,[90] a 1968 case, the Court held constitutional a New York statute that required school districts to loan textbooks to students in grades seven through twelve who were enrolled in any school within the district.[91] The statute did not differentiate between public and private schools, or religious and non-religious schools. Rather, it was a blanket authorization. Relying on the *Everson* rationale, the Court characterized the law as simply making "available to all children the benefits of a general program to lend books free of charge."[92] Moreover, the statute authorized only the loan of secular books, and each book loaned was approved by public school officials.[93] Given the secular nature of the books, the Court refused to abandon its *Everson* rationale, or "child-benefit theory,"[94] and accordingly found the statute not contradictory to the mandate of separation imbedded in the Establishment Clause.[95]

If *Everson* and *Allen* reflected the Court's accommodationist tendencies, *Meek v. Pittinger*[96] embodied its separationist propensities first expressed in *Everson*. In *Meek*, the Court held unconstitutional a statute authorizing public school officials to lend instructional materials directly to nonpublic schools.[97] These materials included books, periodicals, documents, pamphlets, photographs, maps, charts, and globes.[98] Although these materials, like the textbooks in *Allen*, were self-policing and neutral, the Court declared them unconstitutional, stating that the nonpublic schools, rather than the students, were the primary beneficiaries.[99] Despite this ruling, the Court upheld a separate section of the Act which authorized public school officials to lend secular textbooks to religious schools.[100] Yet the Act defined textbooks as books,[101] which the Act further defined as instructional materials,[102] which the Court declared unconstitutional.[103]

The Court only two years following *Meek* passed judgment on yet another instructional materials dispute in *Wolman v. Walter*.[104] *Wolman* involved an Ohio statute which authorized public officials to provide nonpublic school

90. 392 U.S. 236 (1968).
91. *Allen*, 392 U.S. at 238.
92. *Id.* at 243.
93. *Id.* at 244-45.
94. *See* LEVY, *supra* note 9, at 154.
95. *Allen*, 392 U.S. at 248.
96. 421 U.S. 349 (1975).
97. *Meek*, 421 U.S. at 366.
98. *Id.* at 355 n.4.
99. *Id.* at 364-66.
100. *Id.* at 362.
101. *Id.* at 354 n.3.
102. *Id.* at 355 n.4.
103. *Id.* at 366.
104. 433 U.S. 229 (1977).

students not only with instructional materials and equipment and books, but also with standardized testing and scoring services, diagnostic services, therapeutic services, and field trip transportation.[105] After again confirming the constitutionality of secular textbook loan programs,[106] the Court, in a surprising extension of its parochial school decisions, held that Ohio could constitutionally furnish testing and scoring,[107] diagnostic,[108] and therapeutic services.[109] These services, according to the Court, posed insubstantial threats, lacked educational content, or were offered at religious neutral locations.[110] Notwithstanding these rulings, the Court was unwilling to disturb its conclusion in *Meek* that the Establishment Clause prohibited states from loaning instructional materials and equipment to nonpublic schools.[111]

c. *Cash Subsidies and Tax Exemptions*

The parade of parochial school aid cases marched on in *Lemon v. Kurtzman*,[112] where the Court addressed aid to religious schools of an entirely different nature—cash subsidies to parochial schools and their teachers. The companion cases at issue involved statutes passed by the Pennsylvania and Rhode Island legislatures out of concern over the quality of the education at each states' nonpublic schools.[113]

The Rhode Island Act authorized public officials to reimburse nonpublic school teachers of secular subjects up to 15% of their current annual salary.[114] The statute further required eligible schools to submit financial data to the state for determination of the appropriate subsidy amount.[115] Moreover, the Act required eligible teachers to use only secular teaching materials and

---

105. *Wolman*, 433 U.S. at 233.
106. *Id.* at 238.
107. *Id.* at 240-41.
108. *Id.* at 241.
109. *Id.* at 247-48.
110. *Id.* at 242, 244, 248.
111. *Id.* at 249-50. The only distinction between the *Meek* and *Wolman* programs was that the materials and equipment in *Meek* were loaned directly to the school, whereas in *Wolman* it was the pupil or the pupil's parent who was, theoretically, loaned the equipment. *Id.* at 250. Justice Blackmun, presumably with a straight face, noted that "it would exalt form over substance if this distinction were found to justify a result different from that in *Meek*." *Id.* Yet it was this very distinguishing characteristic which the Court deemed so essential in both *Allen* and *Meek* with respect to the textbook programs.

Even further clouding matters in *Wolman* was the Court's fickle decision that it violated the Establishment Clause for nonpublic schools to use public school buses for field trips to "governmental, industrial, cultural, and scientific centers." *Id.* at 252, 255. The Court characterized the bus services in *Everson* as different in nature than the bus services at issue in *Wolman*. The transportation services in *Everson* were routine in that the children were bused only to and from school. *Id.* at 253-54. In contrast, the services in *Wolman* were unique, in that the students were bused to the field trip sites. *Id.* Moreover, field trips are, at least for the Court, rendered meaningful only through the efforts of the individual sectarian teacher. *Id.* at 254. Hence, for the Court, the risk was simply too great that such a teacher would seize the moment and unconstitutionally foster religion. *Id.*

112. 403 U.S. 602 (1971).
113. Rapidly rising costs and low teacher salaries were particular fears the statutes were designed to reverse. *Lemon*, 403 U.S. at 607, 609.
114. *Id.* at 607.
115. *Id.* at 607-08.

teach only secular subjects.[116] The Pennsylvania law, in contrast, authorized the subsidy directly to the parochial schools for those expenses accrued for teacher's salaries, textbooks, and instructional materials.[117] Only courses in math, modern foreign languages, physical science, and physical education were eligible for these reimbursements.[118] Like Rhode Island, however, Pennsylvania required the schools to use specific accounting procedures, submit specific financial data, and if necessary undergo a state audit.[119]

After the Court delineated the three part *Lemon* test,[120] it proceeded to apply its new framework. It began by accepting as valid the requisite secular purpose as described by the respective statutes. It never determined, however, whether the statutes' principal effect advanced religion.[121] Instead, it skipped to the third element and concluded that both statutes excessively entangled government and religion.[122] Because of both the extensive governmental controls necessary to determine compliance and the fact that parochial schools involve "substantial religious activity and purpose," the Court refused to uphold the laws.[123] It distinguished *Allen* by noting that books can be independently inspected once to determine their contents; to assure teacher compliance, however, requires a "comprehensive, discriminating, and continuing state surveillance."[124] The Pennsylvania statute suffered from a further defect in that the aid flowed directly to the school.[125] Coupled with the political divisiveness inherent in the subsidies, the number and nature of entanglements proved too many and too pervasive to justify a finding of constitutionality.[126]

A statute similar in effect but different in design to the one in *Lemon* was that passed by New York granting a package of benefits to nonpublic schools and their students. Specifically, the statute, which was challenged in *Committee for Public Education & Religious Liberty v. Nyquist*,[127] provided direct

---

116. *Id.* at 608.
117. *Id.* at 609.
118. *Id.* at 610.
119. *Id.* at 609-10.
120. Recall that the *Lemon* test proscribes statutes, policies, and actions that have sectarian purposes, primarily affect or advance religion, and foster an excessive entanglement between government and religion. *Id.* at 612-13; *see supra* text accompanying notes 66-69.
121. *Lemon*, 403 U.S. at 613-14.
122. *Id.*
123. *Id.* at 616-17.
124. *Id.* at 619.
125. *Id.* at 621.
126. Disputes over aid to teachers would continue to haunt the Court. Fourteen years after *Lemon*, the Court invalidated two Michigan school district programs using public school funds for various nonpublic school programs and classes. School District of the City of Grand Rapids v. Ball, 473 U.S. 373, 375 (1985). The Shared Time program, which was offered during the school day involved a variety of remedial subjects. *Id.* The Community Education program, in contrast, was offered at the conclusion of the school day. *Id.* at 376. The activities in both programs occurred inside the nonpublic school buildings. *Id.* at 375-76. Although Shared Time program courses were taught by public school teachers, instructors in the Community Education program were conducted by nonpublic teachers, who usually taught at the same nonpublic school where they rendered their Community Education program. *Id.* at 377. The Court struck both programs down, holding that each failed the purpose prong of the *Lemon* test. *Id.* at 385. Of primary importance to the Court were both the effective subsidy provided by the programs, *id.*, and the "substantial risk of state-sponsored indoctrination." *Id.* at 387.
127. 413 U.S. 756 (1973).

grants to nonpublic schools for facilities maintenance and repair as well as tax exemptions and tuition grants to students. Not surprisingly, the Court found all challenged authorizations of the statute unconstitutional.[128]

The provisions authorizing facilities maintenance and repair, which possessed the requisite secular purpose, had the primary effect of advancing religion by allowing sectarian schools to finance all necessary facilities upkeep from taxpayer revenues.[129] Similarly, the tuition reimbursement program also failed to meet the purpose requirement.[130] To this end, the Court noted that "by reimbursing parents for a portion of their tuition bill, the State seeks to relieve their financial burdens sufficiently to assure that they continue to have the option to send their children to religion-oriented schools."[131]

The final component of the New York benefits package bestowed tax exemptions upon parents of nonpublic school students, provided the parents' income was greater than $5000 but less than $25000.[132] As with the tuition grants, however, the Court rejected the argument that the provision was constitutional because the parent rather than the school was the beneficiary.[133] The more difficult task for the Court lay in distinguishing the tax exemption at issue in *Nyquist* from the one in *Walz v. Tax Commission*,[134] a case in which the Court held that the Establishment Clause was not violated by granting churches wholesale tax exemptions.[135] It effectively contrasted *Walz* by noting first that the tax exemption there served the noble purpose of minimizing church and state involvement,[136] and, second, that the exemption essentially applied to a class of organizations composed of many non-religious institutions.[137]

---

128. *Nyquist*, 413 U.S. at 769.

129. *Id.* at 774.

130. *Id.* at 783.

131. *Id.* The excessive financial relief referred to by the Court, however, simply did not exist. The statute capped grants at $100 per child; moreover, a qualifying parent's income could be no greater than $5000. *Id.* at 780. Given these statistics it is doubtful the grants influenced a great number of, if any, parents to send their children to nonpublic schools. Indeed, the opinion overlooked that supplying textbooks and transportation to students similarly lessened the financial burden on parochial school students.

132. *Id.* at 790. The effect was to ensure that all parents of nonpublic school students earning under $25,000 received either a tuition reimbursement grant or a tax credit.

133. *Id.* at 791.

134. 397 U.S. 664 (1970).

135. *Walz*, 397 U.S. at 680.

136. *Nyquist*, 413 U.S. at 793. The Court delineated this as follows:

> To be sure, the exemption of church property from taxation conferred a benefit, albeit a an indirect and incidental one. Yet the "aid" was a product not of any purpose to support or to subsidize, but of a fiscal relationship designed to minimize involvement and entanglement between Church and State. The exemption . . . tends to complement and reinforce the desired separation insulating each from the other. Furthermore, elimination of the exemption would tend to expand the involvement of government by giving rise to tax valuation of church property, tax liens, tax foreclosures, and the direct confrontations and conflicts that follow in the train of those legal processes. The granting of the tax benefits under the New York statute, unlike the extension of an exemption, would tend to increase rather than limit the involvement between Church and State.

Id.

137. *Id.* at 793-94. The class of organizations consisted of corporations and associations organized exclusively for "the moral or mental improvement of men and women, or for religious,

Tax exemptions were again the issue in *Mueller v. Allen*.[138] There, Minnesota allowed taxpayers a deduction for various educational expenses, including tuition, textbooks, and transportation.[139] Although the statute was facially neutral and applied to parents of students attending both public and nonpublic schools,[140] its purpose and effect were suspect because Minnesota law generally prohibited public schools from charging tuition.[141] Nonetheless, the Court considered this facial neutrality paramount in distinguishing the modest deductions available there from the grants and exemptions in *Nyquist*.[142] Moreover, the Minnesota deductions flowed only to the individual parents rather than to the schools themselves,[143] and were part of a comprehensive program of similar deductions provided for in the Minnesota tax laws.[144] Given these distinctions, the Court found the Minnesota statute constitutional.[145]

Justice Marshall, in dissent, took the majority to task for its form over substance decision, which in effect allowed deductions strikingly similar to the exemptions and grants found unconstitutional in *Nyquist*.[146] Describing the majority's attempt to distinguish tax deductions from tax credits and exemptions as "a distinction without a difference,"[147] Marshall relied on the indisputable fact that most of the deduction's beneficiaries were parents of parochial school children.[148] As such, the statute's primary effect unconstitutionally advanced religion.[149]

d. *The Use of Federal Funds*

In 1985 the Court decided *Aguilar v. Felton*,[150] its most criticized and inequitable parochial school aid decision. The facts were simple: New York City used federal funds to provide remedial instruction to children of low-income families on parochial school grounds.[151] The classrooms were free of religious symbols and the government provided the requisite materials.[152]

---

bible, tract, charitable, benevolent, missionary, hospital, infirmary, educational, public playground, scientific, literary, bar association, medical society, library, patriotic, historical or cemetery purposes." *Walz*, 397 U.S. at 667 n.1.

138. 463 U.S. 388 (1983).

139. *Mueller*, 463 U.S. at 391 n.1.

140. *Id.* at 397.

141. *Id.* at 405 (Marshall, J., dissenting).

142. *Id.* at 398. The maximum deduction available was $700. *Id.* at 391. The actual tax savings were, of course, much lower.

143. *Id.* at 399.

144. *Id.* at 396.

145. *Id.* at 403-04.

146. *Id.* at 405.

147. *Id.* at 411.

148. *Id.* at 405. Justice Rehnquist, speaking for the majority, countered, "We would be loath to adopt a rule grounding the constitutionality of a facially neutral law on annual reports reciting the extent to which various classes of private citizens claimed benefits under the law." *Id.* at 401.

149. *Id.* at 414.

150. 473 U.S. 402 (1985).

151. *Aguilar*, 473 U.S. at 405-06.

152. *Id.* at 407.

Only public school personnel effectuated the remedial instruction.[153] Yet, because the aid was "provided in a pervasively sectarian environment,"[154] the necessary oversight fostered an excessive entanglement between church and state.[155] Justice Brennan, who wrote for the majority, feared government agents roaming parochial school halls suspiciously peering inside classrooms and searching profusely for a hint of sectarian influence penetrating the state funded classes.[156] Unfortunately for the 20,000 New York City schoolchildren his decision affected, Brennan proffered no evidence to substantiate this alleged need for pervasive state oversight.

The Court's most recent parochial school aid pronouncement occurred in 1993 in *Zobrest v. Catalina Foothills School District*.[157] The dispute in *Zobrest* centered around James Zobrest, who had been deaf since birth.[158] Although a pupil in the public schools through grade eight, his parents hoped to enroll him in a private religious school for his upcoming ninth grade term.[159] To this end, both James and his parents sought, under the federal IDEA[160] program designed to benefit disabled children, to procure a sign-language interpreter for James's use while attending the private school.[161] Although state officials cited the Establishment Clause as a bar to complying with James's request,[162] the Court sided with Zobrest and found that furnishing the interpreter for use in a private, religious school did not violate the Establishment Clause.[163]

In reaching this conclusion, the Court considered the nature of the benefits received by Zobrest determinative.[164] In particular, the fact that the federal program provided aid to any disabled child without regard to public-private or sectarian-nonsectarian distinctions proved convincing.[165] Furthermore, instead of providing benefits directly to the parochial school, the program merely ensured "that a government-paid interpreter will be present in a sectarian school only as a result of the private decision of individual parents."[166] Because of this choice, no financial incentive existed for James's parents to prefer sectarian to public schools.[167] As a final determinative factor, the Court noted that the school itself was not relieved of any expenses that it

153. *Id.* at 406.
154. *Id.* at 412.
155. *Id.* at 413.
156. *Id.* at 414.
157. 113 S. Ct. 2462 (1993).
158. *Zobrest*, 113 S. Ct. at 2464.
159. *Id.*
160. 20 U.S.C. § 1400 (1992). IDEA is an acronym for the Individuals with Disabilities Education Act. *Zobrest*, 113 S. Ct. at 2464.
161. *Zobrest*, 113 S. Ct. at 2464.
162. *Id.*
163. *Id.* Mention of the *Lemon* test was noticeably absent in *Zobrest*. For an argument that the Court nonetheless relied on the factors embodied in *Lemon*, see Lisa S. Pierce, *Making Aid Without* Lemon*?*, 63 U. CIN. L. REV. 565 (1994).
164. *Zobrest*, 113 S. Ct. at 2467.
165. *Id.*
166. *Id.*
167. *Id.*

would have incurred had the government not provided the interpreter.[168] Hence, one is hard-pressed to find fault with the Court's assertion that in *Zobrest*, "Handicapped children, not sectarian schools, are the primary beneficiaries of the IDEA."[169]

2. Public Education and the Establishment Clause

a. *Released Time Programs*

In 1948, just one year after its historic decision in *Everson*, the Court in *McCollum v. Board of Education*[170] decided its first public education case and addressed the so called "released time" programs. Under these arrangements, students in public schools were "released" during the school day from regular classes to receive religious instruction. In *McCollum*, this instruction was carried out by religious teachers inside the schoolhouse.[171] Only those students whose parents consented could attend the religion classes; other students were excused from participation but remained confined on school grounds.[172] Writing for an 8-1 majority, Justice Black found that the program violated the Establishment Clause and was therefore unconstitutional.[173] Of primary importance to the Court was the use of the state's compulsory education machinery to provide students for religious instruction classes.[174] This, according to Black, was an impermissible use of the tax-supported public schools to aid religious groups in spreading their faith.[175]

Proponents of released-time programs were not discouraged by the mandate of separation inherent in *McCollum*, and just four years later managed to bring the issue before the Court once again. The released time program in *Zorach v. Clauson*[176] presented an interesting twist on the *McCollum* program—the students under the *Clauson* plan received instruction not on school grounds but instead at various religious facilities.[177] So in both cases the instruction occurred during the school day, but in *McCollum* the religious teachers went to the children, while in *Clauson* the children went to the religious teachers. Drawing on this distinction, a 6-3 Court found the *Clauson* program constitutional. Speaking for the majority, Justice Douglas stated that "[t]he First Amendment . . . does not say that in every and all respects there shall be a separation of Church and State."[178] Effecting such an assumption, rather than making the state neutral, Douglas observed, would render it hostile to religion.[179] Such hostility is neither mandated by the Constitution nor in ac-

168. *Id.* at 2469.
169. *Id.*
170. 333 U.S. 203 (1948).
171. *McCollum*, 333 U.S. at 209. Teachers included Catholic priests, Jewish rabbis, and Protestant instructors. *See id.*
172. *Id.* at 207-09.
173. *Id.* at 210. The lone dissenter was Justice Reed. *Id.* at 238.
174. *Id.* at 212.
175. *Id.* at 210.
176. 343 U.S. 306 (1952).
177. *Clauson*, 343 U.S. at 308.
178. *Id.* at 312.
179. *Id.*

cordance with our history as a religious people.[180] In any event, and despite the apparent inconsistencies between the two released time decisions, *Clauson* nonetheless continues to serve as the Court's definitive answer to the released time issue.[181]

b. *School Prayer, Bible Reading, and Creation Science*

The zenith of the Court's separationist campaign, as well as its most controversial Establishment Clause decision, was handed down a decade after *Clauson* when in *Engel v. Vitale*,[182] a 6-1 Court declared that prayer in school was unconstitutional.[183] The prayer at issue in *Engel* was nondenominational and read as follows: "Almighty God, we acknowledge our dependence upon Thee, and we beg Thy blessings upon us, our parents, our teachers and our Country."[184] Students not wishing to recite the prayer were allowed either to remain silent or leave the room.[185] In contrast to the Free Exercise Clause, however, Establishment Clause claims do not *require* that a coercive element be present.[186] Hence, the opportunity for students to not participate played no role in determining the recital's constitutionality. Rather, the relevant issue was simply whether the state had forged an unconstitutional union between religion and government. Given that here the state had composed an

---

180. *Id.* at 314. Douglas expounded on this notion as follows:

> We are a religious people whose institutions presuppose a Supreme Being. We guarantee the freedom to worship as one chooses. We make room for as wide a variety of beliefs and creeds as the spiritual needs of man deem necessary. We sponsor an attitude on the part of government that shows no partiality to any one group and that lets each flourish according to the zeal of its adherents and the appeal of its dogma. When the state encourages religious instruction or cooperates with religious authorities by adjusting the schedule of public events to sectarian needs, it follows the best of our traditions.

Id. at 313-14.

181. Justices Black, Frankfurter, and Jackson each wrote dissenting opinions, essentially arguing that there were no distinctions between *McCollum* and *Clauson*. Justice Black in particular relied upon a supposed element of coercion implicit in the state's compulsory education laws. *Id.* at 318 (Black, J., dissenting). Black, however, confused the compulsion to attend public schools with the compulsion to attend the religion classes; the second was a result of free exercise, the first was not. Attendance at the religion classes required parental consent, and because the instruction itself was removed from the school grounds, the attendant air of authority and endorsement in *McCollum* ceased to exist in *Clauson*.

Note, however, that the released time programs should be constitutional only to the extent that they do not "punish" dissenters or those who for whatever reason opt out of attending the religion classes. For these students, the school should not during this time become, as Justice Jackson feared it would, a "jail for the pupil who will not go to Church." *Id.* at 324 (Jackson, J., dissenting).

182. 370 U.S. 421 (1962).

183. *Engel*, 370 U.S. at 424. Justices Frankfurter and White did not participate in the Court's decision.

184. *Id.* at 422.

185. *Id.* at 430.

186. *Id.* This does not mean, however, that laws which establish religion do not coerce compliance. "When the power, prestige and financial support of government is placed behind a particular religious belief, the indirect coercive pressure upon religious minorities to conform to the prevailing officially approved religion is plain." *Id.* at 431. This element, however, is an issue to be resolved under the Free Exercise Clause. Compare Justice Douglas's concurring opinion which states that "there is no element of compulsion or coercion in New York's regulation." *Id.* at 438.

official prayer to be recited by a group of Americans, the Court had little difficulty finding such a forbidden coupling.[187]

Public reaction to the Court's decision, although expected to be harsh, was extremely intense.[188] In Congress, representatives and senators rushed to sponsor a nullifying constitutional amendment.[189] One senator rhetorically queried whether "we, too are ready to embrace the foul concept of atheism."[190] Another maintained that "the Supreme Court has made God unconstitutional."[191] Criticism of the decision was not, however, limited to federal officials. The Conference of State Governors voted unanimously to call for an overruling constitutional amendment.[192] Members of the clergy were "shocked and frightened" and marvelled at the Court's insensitivity to America's religious tradition.[193] One popular evangelist noted the increasing secularization of the United States and argued that "[t]he Framers of our Constitution meant we were to have freedom of religion, not freedom from religion."[194]

Although intense, the criticism was not unanimous. In fact, several Protestant organizations and individuals, including the Joint Baptist Committee on Public Affairs, *The Christian Century*, and the Reverend Martin Luther King, opposed the movement for a constitutional amendment, as did nearly all Jewish organizations and rabbis.[195] Unexpectedly, many of the nation's major newspapers, including the *New York Times* and the *Washington Post*, supported the decision.[196] In any event, the movement and support for a constitutional amendment dwindled as none of the proposals garnered the necessary two-thirds majority.[197]

Notwithstanding this reaction, the Court only one year later in *Abbington Township School District v. Schempp*[198] considered and held unconstitutional the equally divisive issue of Bible reading in public schools. *Abbington Township* consisted of two companion cases in which the legislature of Pennsylvania and the Board of School Commissioners of Baltimore mandated that the

---

187. *Id.* at 425. Interestingly, Justice Douglas, a member of the *Everson* majority which upheld the New Jersey law against an Establishment Clause attack, admitted his decision was wrong. Recall that *Everson* was a 5-4 decision. *See supra* text accompanying notes 73-89.

188. The effects on the Court's Establishment Clause jurisprudence were great as well. In fact, Professor Ira Lupu describes the decision, along with the other school prayer cases, as one of five crucial gestures of the Court in its "embrace of the separationist ethos" between 1947-1980. Ira C. Lupu, *The Lingering Death of Separationism*, 62 GEO. WASH. L. REV. 230, 233-34 (1994).

189. STOKES & PFEFFER, *supra* note 45, at 378.

190. *Id.*

191. LEVY, *supra* note 9, at 185.

192. STOKES & PFEFFER, *supra* note 45, at 378.

193. *Id.*

194. *Id.* (statement of Reverend Dr. Billy Graham).

195. *Id.* at 379.

196. *Id.* Press support was certainly not unanimous. Indeed, Levy reports that "newspaper headlines screamed that the Court had outlawed God from the public schools." LEVY, *supra* note 9, at 185.

197. LEVY, *supra* note 9, at 185. In recent years there has been renewed increase in securing a constitutional amendment to restore prayer in schools. For one author's view that such an amendment impedes upon religious freedoms, see Robert S. Peck, *The Threat to the American Idea of Religious Liberty*, 46 MERCER L. REV. 1123 (1995).

198. 374 U.S. 203 (1963).

Bible be read aloud to students at the beginning of the school day.[199] Specifically, Pennsylvania required that at least ten verses be read and the Lord's Prayer thereafter recited.[200] No comments accompanied the reading and those children whose parents requested in writing were excused.[201] These nonparticipants, however, could in effect not escape the reading, as it was broadcast over the school's intercommunications system.[202] Baltimore's plan was substantially similar. It authorized one chapter to be read from the Bible and authorized nonparticipation if the child's parents consented.[203]

In a precursor to the *Lemon* test, the Court examined the "purpose and the primary effect of the encroachment," and noted that enactments which either advance or inhibit religion violate the Establishment Clause.[204] Hence, to withstand Establishment Clause scrutiny "there must be both a secular legislative purpose and a primary effect that neither advances nor inhibits religion."[205] Applying these principles, the Court found both the Pennsylvania and Baltimore directives unconstitutional.[206] Although both laws had secular purposes, the primary effect of each was religious in nature.[207] Moreover, the Court reiterated its earlier implicated position that coercion is not a predicate for an Establishment Clause violation.[208] As such, the ability of students to opt out of the readings was irrelevant.[209]

In his concurrence, Justice Brennan launched into an exhaustive historical discussion, but in an odd move simultaneously eschewed history. Instead of strict reliance on history, Brennan preferred to base his decision upon "whether the practices here challenged threaten those consequences which the Framers deeply feared; whether, in short, they tend to promote that type of interdependence between religion and state which the First Amendment was designed to prevent."[210] Hence, Brennan stated that fruitless searches into the minds of Madison, Jefferson, Washington, and the other Founders to determine what each would have thought, either individually or collectively, with respect to modern church-state issues were useless. Invoking John Marshall's often used but essentially meaningless utterance that "we must never forget that it is a Constitution we are expounding," Brennan proclaimed that the Court should only use the Founders' history for its broad purposes rather than

199. *Abbington Township*, 374 U.S. at 205, 211.
200. *Id.* at 207.
201. *Id.*
202. *Id.*
203. *Id.* at 211.
204. *Id.* at 222.
205. *Id.* (quoting McGowan v. Maryland, 366 U.S. 420, 442 (1961)).
206. *Id.* at 226-27.
207. *Id.* at 223-24. Proponents of both programs asserted that each was passed for secular reasons, such as "the promotion of moral values, the contradiction to the materialistic trends of our times, the perpetuation of our institutions and the teaching of literature." *Id.* at 223.
208. *Id.*
209. *Id.* at 224-25.
210. *Id.* at 236 (Brennan, J., concurring).

its specific practices.[211] Brennan failed to recognize, however, that specific practices are the broad purposes put into action.

In 1985 the specter of school prayer again reared its head, this time in the intensely controversial guise of moments of silence. Since 1962 and the Court's decision outlawing school prayer, critics had been searching faithfully for a comparable surrogate which could pass constitutional muster. At least twenty-five states had found what appeared to be a workable constitutional substitute.[212] These states authorized moments of silence at the beginning of each school day, during which students were free to meditate, pray, or simply sit quietly. The empowering legislation in these various states, however, only authorized a moment of silence—neither the statute, nor in theory the public school officials, encouraged students to use the moment of silence for prayer. Alabama fell into this category until 1981, when it amended its moment of silence statute to authorize a "period of silence 'for meditation or voluntary prayer.'"[213] Just one year later in 1982 it further amended the statute to allow teachers to lead willing students in a voluntary prayer.[214] These amendments led to *Wallace v. Jaffree*,[215] an extraordinary case which for many reasons[216] wound its way quickly through the federal dockets to the Supreme Court.

Significantly, the plaintiff in *Wallace* did not challenge Alabama's original and still valid moment of silence statute. Rather, plaintiff objected to the two amended versions, which in his mind, encouraged prayer, either silently or aloud.[217] Moreover, because the Court in a previous opinion had ruled the second amended version, which authorized teachers to lead willing students in prayer, unconstitutional, the sole and narrow issue considered was the addendum to the statute which explicitly authorized use of the moment of silence for voluntary prayer.[218] Applying *Lemon*, the Court concluded that the statute's sole purpose was to advance religion.[219] Both the legislative history and the testimony of the bill's primary sponsor made this determination an easy one. State Senator Donald G. Holmes, when testifying before the District

---

211. *Id.* at 241. Brennan's view held that the Establishment Clause prohibits "those involvements of religious with secular institutions which (a) serve the essentially religious activities of religious institutions; (b) employ the organs of government for essentially religious purposes; or (c) use essentially religious means to serve governmental ends, where secular means would suffice." *Id.* at 295.

212. Wallace v. Jaffree, 472 U.S. 38, 70 (1985) (O'Connor, J., concurring).

213. *Id.* at 40.

214. *Id.*

215. 472 U.S. 38 (1985).

216. One of these reasons was the maverick opinion of the district court judge, who rebelliously concluded that the two amended statutes were an attempt by Alabama to encourage religious activity, but proceeded to find them constitutional because "the establishment clause of the first amendment to the United States Constitution does not prohibit the state from establishing a religion." *Wallace*, 472 U.S. at 41, 45. In short, the judge single-handedly attempted to expunge the Court's previously determined Fourteenth Amendment incorporation of the Establishment Clause. Not surprisingly, the Court took offense at the judge's attempted rebellion and reaffirmed its commitment to incorporation. *Id.* at 48-49.

217. *Id.* at 41.

218. *Id.* at 41-42.

219. *Id.* at 55-56.

Court, stated the bill was "an effort to return voluntary prayer to our public schools" and that passage of this bill was "a beginning and a step in the right direction."[220] When asked if this was his sole motivation for passage of the bill, he stated, "I did not have no other purpose in mind."[221] Similar statements appeared in the statute's legislative history.[222] Contrasting this intent with a law which simply protects "every student's right to engage in voluntary prayer during an appropriate moment of silence,"[223] the Court stated that the statute's endorsement of the manner in which the moment of silence was to be used violated the principle of government neutrality toward religion.[224]

The Court's most recent statement addressing school prayer is its 1992 decision of *Lee v. Weisman*,[225] in which the Court held prayer at graduation ceremonies unconstitutional. Writing for the majority, Justice Kennedy noted the pervasive involvement of government and religion in commencement prayers.[226] Following this, he briefly mentioned the *Lemon* test[227] but then based his opinion on the supposed element of coercion implicit in the commencement exercise,[228] all the while overlooking that the Court had expressly repudiated the existence of such a factor, either implicit or explicit, in Establishment Clause claims.[229]

---

220. *Id.* at 43.

221. *Id.* at 57.

222. *Id.* at 57 n.43.

223. *Id.* at 59.

224. *Id.* at 60. All indications are that had the statute proffered some secular purpose, it would have survived scrutiny. For example, Justice Powell in concurrence stated outright that he "would vote to uphold the Alabama statute if it also had a clear secular purpose." *Id.* at 66 (Powell, J., concurring). Similarly, Justice O'Connor differentiated the Alabama statute from other moment of silence authorizations because its unavoidable conclusion pointed to the state's intent to endorse prayer in public schools. *Id.* at 77 (O'Connor, J., concurring). Justices Rehnquist, White, and Burger supported a finding of constitutionality in spite of the statute's alleged voluntary prayer endorsement. *Id.* at 85-91 (Burger, J., dissenting). Justice White considered the statute as merely providing a preemptive legislative answer to a student's inquiry as to whether the moment of silence could be used for prayer. *Id.* at 91 (White, J., dissenting). Burger remarked that simply amending the statute to permit voluntary prayer did not constitute an endorsement, and, furthermore, no evidence existed which suggested that the entire Alabama legislature accepted the sponsor's motive. *Id.* at 85-87 (Burger, J., dissenting). Rehnquist attacked the Court's strict-separationist history, and again put forth his historical argument for nonpreferentialism, claiming that even generalized endorsements of voluntary prayer did not violate the Establishment Clause. *Id.* at 113-14 (Rehnquist, J., dissenting).

225. 112 S. Ct. 2649 (1992).

226. *Lee*, 112 S. Ct. at 2655.

227. *Id.*

228. *Id.* at 2661 ("The sole question presented is whether a religious exercise may be conducted at a graduation ceremony in circumstances where, as we have found, young graduates who object are induced to conform."). Kennedy reiterated this coercion element throughout the opinion. For example, at another point, he states:

> The undeniable fact is that the school district's supervision and control of a high school graduation ceremony places public pressure, as well as peer pressure, on attending students to stand as a group or, at least maintain a respectful silence during the Invocation and Benediction. This pressure, though subtle and indirect, can be as real as any overt compulsion.

Id. at 2658; *see supra* text accompanying note 186.

229. For an argument in favor of Justice Kennedy's coercion test, see Timothy C. Caress, *Is Justice Kennedy the Supreme Court's Lone Advocate for the Coercion Element in Establishment Clause Jurisprudence? An Analysis of* Lee v. Weisman, 27 IND. L. REV. 475 (1993); *see also* Symposium, *Religion and the Public Schools After* Lee v. Weisman, 43 CASE W. L. REV. 795

For this reason, Blackmun and Souter wrote concurring opinions, both joined by Stevens and O'Connor. Blackmun applied the *Lemon* test and concluded that the prayer served an unconstitutional religious purpose.[230] Moreover, Blackmun believed that the government, by placing its imprimatur upon the prayer, had undoubtedly advanced and promoted religion.[231] For his part, Souter wrote to defend the Court's no-aid approach of forty-five years from what he may have perceived as increasing pressure to embrace a more accommodationist, nonpreferentialist philosophy.[232] This wing of the Court, now numbering four,[233] voiced itself in Scalia's dissent, which bashed both Kennedy's coercion test (described by Scalia as the Court's "psycho-journey")[234] and the concurring Justices reliance on *Lemon*.[235] As one commentator notes, *Lee v. Weisman* was just the first shot in the commencement prayer battle.[236]

Between the prayer issues involved in *Wallace* and *Lee*, the Court addressed a public education issue of a different kind—whether states could require public school teachers to instruct students on the topic of "creation science." The case which presented this issue, *Edwards v. Aguillard*,[237] involved a Louisiana statute requiring public schools which taught evolution to also teach what it termed creation science, or "the scientific evidence for creation and inferences from those scientific evidences."[238] Despite the fact that

---

(1993) (debating whether *Lee v. Weisman* marked the end of the *Lemon* test and served as a prelude to development of a coercion test).

230. *Lee*, 112 S. Ct. at 2663 (Blackmun, J., concurring).

231. *Id.* at 2664.

232. *Id.* at 2667 (Souter, J., concurring). Ironically, both Souter and Scalia drew from the same historical practices and works, including those of Madison, to reach their diametrically opposed conclusions. *Id.* at 2674, 2680.

233. These four were Justices Scalia, White, and Thomas, as well as Chief Justice Rehnquist. *Id.* at 2678.

234. *Id.* at 2684.

235. *Id.* at 2685. In contrast to limiting religious harmony, Scalia characterized the scenario as follows:

> The founders of our Republic knew the fearsome potential of sectarian religious belief to generate civil dissension and civil strife. And they also knew that nothing, absolutely nothing, is so inclined to foster among religious believers of various faiths a toleration—no, an affection—for one another than voluntarily joining in prayer together, to the God whom they all worship and seek. Needless to say, no one should be compelled to do that, but it is a shame to deprive our public culture of the opportunity, and indeed the encouragement, for people to do it voluntarily. The Baptist or Catholic who heard and joined in the simple and inspiring prayers of Rabbi Gutterman on this official and patriotic occasion was inoculated from religious bigotry and prejudice in a manner that can not be replicated. To deprive our society of that important unifying mechanism, in order to spare the nonbeliever what seems to me the minimal inconvenience of standing or even sitting in respectful nonparticipation, is as senseless in policy as it is unsupported in law.

Id. at 2686.

236. LEVY, *supra* note 9, at 204.

237. 482 U.S. 578 (1987).

238. *Edwards*, 482 U.S. at 581. In 1968, the Court had grappled with a substantially similar problem. In Epperson v. Arkansas, 393 U.S. 97 (1968), the Court held invalid an Arkansas statute which prohibited public schools from teaching, or using any textbook which taught the theory of evolution. *Id.* at 98-99. Although the Court recognized the power of the state to proscribe the scope of its public school curriculum, it held that such power did not extend to those acts whose purpose was to excise a particular topic because it was contrary to widely held religious beliefs

the Louisiana legislature's stated purpose in passing the Act was to protect academic freedom,[239] the Court probed the substantial legislative history and concluded that the legislature had identified no clear secular purpose.[240] Instead, the Court concluded the Act's primary purpose was to "advance the religious viewpoint that a supernatural being created humankind."[241] Although the Court reached this conclusion by purportedly relying on the Act's legislative history,[242] Justices Scalia and Rehnquist pointed out in dissent that the history evidenced *no intent* to advance religion.[243] Instead, the history, as recorded over a period of nearly a year, demonstrated that the Act's stated purpose was indisputably secular.[244] According to Scalia the majority relied not on the stated purpose of the Act in striking it down, but rather on the religious motivations of those who initially passed the Act.[245] Hence, the majority overlooked that the Establishment Clause does not forbid laws passed for religious motivations, but rather laws that have the purpose of advancing religion.[246] Moreover, the Court had historically accepted a legislature's stated secular purpose without subjecting that purpose to any examination, let alone the type of legal gymnastics required to imply a nonsecular purpose to the Louisiana law here.[247] Nonetheless, the majority was unable to conceive of a nonreligious theory of creationism, and more or less equated creation science with the theory of creation as proffered in the Bible.[248] Given this mindset, it is no doubt the Court never wavered from its conclusion that the Louisiana law's primary and unconstitutional purpose was to advance religious beliefs.

c. *Equal Access*

At the same time that the moment of silence, commencement ceremony, and creation science disputes were brewing, another issue involving the public schools was coming to a head. That issue was equal access to public school facilities—access not only for students but also for other community organizations. The first case to address this issue was the 1990 decision of *Board of Education of the Westside Community Schools v. Mergens*.[249] There, a Nebraska secondary school cited the Establishment Clause and an express school board policy in denying Bridget Mergen's request to form a Christian club at

---

and violative of the Establishment Clause. *Id.* at 107-08.

239. *Edwards*, 482 U.S. at 581.

240. *Id.* at 585.

241. *Id.* at 591.

242. *Id.* at 591 n.10, 591-92.

243. *Id.* at 610 (Scalia, J., dissenting).

244. *Id.* at 620-21.

245. *Id.* at 614-15.

246. *Id.*

247. *Id.* at 613.

248. *See* LEVY, *supra* note 9, at 192. Justice Brennan

> regarded creation science as if it were an oxymoronic term for a religious belief; he did not address himself to the fact that it claimed to be scientific and to rest on scientific evidence. He saw only the relation between creationism and the Book of Genesis. In that regard his opinion for the Court was unfair and misleading.

Id.

249. 496 U.S. 226 (1990).

the school.[250] This denial, based on the Court's separationist precedent, was made in spite of the school's recognition of at least thirty other student groups.[251] In response to the denial, Mergens, who was a student at the school, sued the school board under the Equal Access Act, a federal law which prohibited public secondary schools receiving federal financial assistance from denying students equal access to open forums based on the content of the students' speech.[252]

Although the school board raised the shield of the Establishment Clause as its defense, the majority effectively side-stepped the issue by limiting its holding to the conclusion that the Act itself required the school to allow the club.[253] The critical issue thus became whether, as the school board alleged, the Act itself violated the Establishment Clause. In holding that it did not, the Court noted that "if a State refused to let religious groups use facilities open to others, then it would demonstrate not neutrality but hostility toward religion."[254] To this end, the Court proceeded to apply the *Lemon* test and deemed it met, finding both a secular legislative purpose which was not intended to endorse or disapprove of religion, and no excessive government/religion entanglement.[255]

An open issue after *Mergens* was whether public schools which had policies allowing community groups to use school facilities after the conclusion of the school day were compelled to prohibit use of the grounds to religious groups or groups with religious purposes. The Court addressed this issue in *Lamb's Chapel v. Center Moriches Union Free School District*,[256] and in a relatively brief opinion concluded that no Establishment Clause violation occurred by allowing a church group after-hours access to show a film, the viewing of which was open to the public, on school grounds.[257] According to the Court, these factors ensured the absence of any realistic danger that outsiders would perceive the school as endorsing a religion or creed.[258] As did the coercion issue in *Lee v. Weisman*, this inquiry into endorsement evoked strong responses from Justices Scalia and Kennedy, who both concurred in the decision.[259] Notwithstanding this internal quibbling among the Justices, it at least appears that given *Mergens* and *Lamb's Chapel*, the Court as a whole is committed to preserving equal rights of access for, and preventing unfair discrimination against, religious groups and groups with religious messages seeking to use public school facilities.

---

250. *Mergens*, 496 U.S. at 232-33.
251. *Id.* at 231.
252. *Id.* at 233 (citing 20 U.S.C. §§ 4071-4074 (1992)).
253. *Id.* at 247.
254. *Id.* at 248.
255. *Id.* at 248-50, 252.
256. 113 S. Ct. 2141 (1993). For in-depth discussions of *Lamb's Chapel*, see Wirt P. Marks, *The* Lemon *Test Rears Its Ugly Head Again*: Lamb's Chapel v. Center Moriches Union Free School District, 27 U. RICH. L. REV. 1153 (1993); Robert P. Viar, Jr., Lamb's Chapel v. Center Moriches Union Free School District: *A Modest Home for God in the Public Schools*, 71 U. DET. MERCY L. REV. 965 (1994).
257. *Lamb's Chapel*, 113 S. Ct. at 2148.
258. *Id.*
259. *Id.* at 2149, 2151.

Undoubtedly, one of the Court's oddest and most unjust public school cases is the 1994 decision of *Board of Education of Kiryas Joel Village School District v. Grumet*.[260] Kiryas Joel is a village composed entirely of members of the Satmar Hasidic sect,[261] who attempt, at all costs, to avoid assimilation into the modern world.[262] To this end, all children attend private religious schools, except for the few, numbering approximately forty, who are mentally handicapped.[263] Although these children received special education services from public school teachers at a nearby parochial school, this practice ceased in 1985.[264] After the Court's mandate in *Aguilar*, these children were forced to attend public schools outside the village.[265] This arrangement lasted only a short time, however, as most parents removed their children from the secular schools because of the attendant emotional distress and trauma wrought by the children's attendance.[266] To alleviate the problem, the New York legislature passed in 1989 a statute creating a separate school district for the village.[267] This district was designed to deal particularly with the needs of the handicapped children, and all evidence suggested that the only school operated by the new district provided special education for these handicapped children.[268] Moreover, Kiryas Joel students were not the only members of this school; several neighboring districts sent similarly handicapped children to the Kiryas Joel school district. In fact, two-thirds of the students came from outside the village.[269]

Notwithstanding that the authorizing statute made not one mention of religion, and that the only courses offered at the school were secular in nature, the Court found the Kiryas Joel district unconstitutional.[270] Justice Souter, writing for a 6-3 majority, concluded that the New York legislature had unconstitutionally created a school district based on nothing but the inhabitants' religion.[271] In short, Souter noted that "a state may not delegate its civil authority to a group chosen according to a religious criterion."[272] To do so violated the Establishment Clause's mandates of government neutrality.[273]

In a blistering attack on the majority's incredulous decision, Justice Scalia, joined by Justice Thomas and Chief Justice Rehnquist, took the Court to task

---

260. 114 S. Ct. 2481 (1994). For discussions of *Kiryas Joel*, see Basilios E. Tsingos, *Forbidden Favoritism in the Government Accommodation of Religion:* Grumet *and the Case for Overturning* Aguilar, 18 HARV. J.L. & PUB. POL'Y 867 (1995) (maintaining that *Kiryas Joel* conforms with the requisite separation of church and state); Note, *Sorting Through the Establishment Clause Tests, Looking Past the* Lemon, 60 MO. L. REV. 653 (1995) (discussing the Justices' failure to develop a workable alternative to the *Lemon* test).

261. *Kiryas Joel*, 114 S. Ct. at 2484.
262. *Id.* at 2485.
263. *Id.* at 2486.
264. *Id.* at 2485.
265. *Id.*
266. *Id.*
267. *Id.* at 2486.
268. *Id.*
269. *Id.*
270. *Id.* at 2484.
271. *Id.* at 2487.
272. *Id.* at 2488.
273. *See id.* at 2491.

for its blindness to the facts and its obtuse application of the Establishment Clause. In dissent, Scalia remarked that, "The Court today finds that the Powers That Be, up in Albany, have conspired to effect an establishment of the Satmar Hadism; I do not know who would be more surprised at this discovery: the Founders of our Nation or Grand Rebbe Joel Teitelbaum, founder of the Satmar."[274] Scalia, whose historical analysis is sometimes questionable, grasped the issue here. As historian Leonard Levy notes, Scalia perceived the Satmar Hadist's peculiarities as cultural, not religious; hence, to hold, as Souter and the majority did, that protection of this small minority sect violated the Establishment Clause is inapposite to the very reason for the entire Constitution's existence.[275] In short, *Kiryas Joel* represents little more than the culmination of forty years of unduly rigid separationism.

3. Higher Education and the Establishment Clause

Establishment Clause challenges to statutes and policies involving higher education are not only fewer in number but also lower in profile than those concerning primary or secondary education in both private and public schools. This is due in part to the widely-held creed that higher education, and university campuses in particular, hold innate a preeminent level of academic freedom. Moreover, the Court understands that university students are less impressionable than schoolchildren, whose sensitive needs it seeks to protect from overwhelming religious pressures.

As with aid to parochial schools, aid to religiously-affiliated colleges and universities generates a substantial amount of the higher education Establishment Clause litigation. Consider in this respect *Tilton v. Richardson*,[276] a 1971 decision in which the Court sustained provisions of a federal act "provid[ing] construction grants for buildings and facilities used exclusively for secular educational purposes."[277] Although private religious institutions undoubtedly benefitted from the grants, the Act itself was facially neutral, and "carefully drafted" to ensure the colleges would engage in only secular functions within the federally funded facilities.[278] As such, the holding, like those in *Everson* and *Allen*, simply permitted sectarian institutions to participate in and receive the benefits of neutral governmental assistance programs.[279]

---

274. *Id.* at 2505-06 (Scalia, J., dissenting).

275. *See* LEVY, *supra* note 9, at 256. Levy further noted that this case was about the special needs of handicapped children and "not at all about religious education." *Id.* As such, the child-benefit theory, which neither the majority or the dissent considered, should have been controlling. *Id.*

276. 403 U.S. 672 (1971).

277. *Tilton*, 403 U.S. at 674-75.

278. *Id.* at 679. Note, however, that the Court did strike down one provision limiting the use on secular restrictions to twenty years. *Id.* at 683. Because there was no guarantee and mechanism for ensuring that the facilities would not then be used for sectarian activities, the Court effectively extended the provision's time frame and the corresponding restriction on sectarian use to the life of the facility. *Id.*

279. *Id.* at 679.

A statute similar in effect to that in *Tilton* was at issue in *Hunt v. McNair*.[280] The mechanism through which the state tendered the aid, however, was substantively different. South Carolina permitted colleges and universities to submit to a state authority proposals for construction of various educational facilities.[281] Upon receipt of a proposal, the authority issued revenue bonds, the proceeds of which the college received and used to fund the proposed project.[282] The college, in turn, conveyed the project to the authority, which then leased the project back to the college until the institution paid back the bond amount.[283] By adhering to this procedure the authority ensured no taxpayer funds supported private religious institutions.[284] Unable to significantly distinguish the aid in *Hunt* from that approved only two terms before in *Tilton* the Court sustained the South Carolina statute.[285]

Three years after *Hunt*, the Court in *Roemer v. Board of Public Works of Maryland*[286] sustained a Maryland statute authorizing grants to private colleges. Although the funds could be used only for secular purposes,[287] the subsidies were undoubtedly substantial and of a more pervasive nature than the construction grants or revenue bonds at issue in *Tilton* or *Hunt*. As in *Tilton*, however, the Court relied on its "participation in government benefit programs" rationale to lend credence to its decision.[288] Lost in the shuffle, however, was the fact that in *Tilton* and *Hunt* the legislation authorized benefits on a neutral basis—that is, both public and private parties purportedly benefitted equally. Here, the law by its terms applied only to private institutions. Hence, the only conceivable rationale for the Court's invocation of the government benefit theory posits that to preclude private religious institutions from government aid distributed to other private institutions constitutes discrimination against, or governmental hostility towards, religion.

The Court in *Roemer* further delineated the function and scope of the primary effect analysis in the higher education context. Relying on the approach set forth in *Hunt*, the Court characterized the primary-effect element as both prohibiting state aid from flowing to institutions so pervasively sectarian that secular activities cannot be separated from sectarian ones, and permitting funding only of those secular activities which can be so separated.[289] Here, although religion or theology courses were mandatory and some classes began with prayer, the Court deemed both requirements met.[290] Important in this respect was that faculty hiring decisions were made on a religion-blind basis, ensuring the appropriate level of professional standards as well as relegation of

280. 413 U.S. 734, 736 (1973).
281. *Hunt*, 413 U.S. at 736-37.
282. *See id.* at 737-38.
283. *Id.*
284. *Id.* at 738.
285. *Id.* at 746-49.
286. 426 U.S. 736 (1976).
287. *Roemer*, 426 U.S. at 740-41.
288. *Id.* at 745-47.
289. *Id.* at 753-54.
290. *Id.* at 756-57.

religious matters to the periphery of the overall institutional environment.[291] As to matters of sectarian funding, the Court uncharacteristically appeared content to trust the judgment of the state oversight council and the institutions themselves.[292]

One of the Court's most reasonable (and reasoned) Establishment Clause decisions is *Witters v. Washington Department of Services for the Blind*.[293] There, the Court held the Clause did not prevent a state from providing financial assistance, as part of a comprehensive statute authorizing aid to visually handicapped persons, to a blind person attending a private religious college and studying for a career in the ministry.[294] In short, the Court reasoned the aid flowed only to the religious institution as "a result of the genuinely independent and private choices of aid recipients."[295] Hence, the individual, rather than the state, made the decision to support the religious institution.[296] Moreover, because the statute made the aid available to Witters regardless of where he chose to pursue his education, it devised no financial incentive for him to choose sectarian education over secular education.[297]

It was not aid but access at the heart of the dispute in *Widmar v. Vincent*,[298] a 1981 case in which the Court required a university to permit religious groups to meet in university facilities.[299] By opening its doors generally to other groups, the university had created an open forum and was therefore obligated to justify its discriminations and exclusions.[300] Because the university's only rationale for excluding the group was the religious content of its speech,[301] the First Amendment required the university to proffer a compelling interest for its discrimination.[302] Although the Court agreed that complying with the constitutional mandates inherent in the Establishment Clause constituted a compelling interest, it nonetheless held that neutral policies were not "incompatible with this Court's Establishment Clause cases."[303] Such open-forum policies, the Court concluded, had neither a religious purpose nor the primary effect of advancing religion.[304] Nor, as the university alleged, would allowing religious groups access create a perception of state endorsement of religion, any more than allowing a "Young Socialist Alliance" group access would confer a state imprimatur of socialism.[305] Hence, at least in this

291. *Id.* at 757-58.
292. *Id.* at 760.
293. 474 U.S. 481 (1986).
294. *Witters*, 474 U.S. at 482.
295. *Id.* at 488.
296. *Id.*
297. *Id.*
298. 454 U.S. 263 (1981).
299. *Widmar*, 454 U.S. at 264-65.
300. *Id.* at 267.
301. *Id.* at 269.
302. *Id.* at 270.
303. *Id.* at 271.
304. *Id.* at 273.
305. *Id.* at 274.

instance, both the Free Speech and Free Exercise Clauses limited the applicability of the Establishment Clause.[306]

C. *Religious Symbols and the Establishment Clause*

The debate over establishment, and the corresponding controversy over nonpreferentialism and separationism, rarely exists outside of the educational context. Nonetheless, the most recent addition to the long list of potentially divisive Establishment Clause issues is the placement of governmentally sponsored religious symbols on public or private land during the holiday season. In only two decisions regarding the appropriateness of such symbols, however, the Court managed to produce a multiplicity of inconsistent opinions. In 1984 the Court in *Lynch v. Donnelly*[307] sustained an Establishment Clause attack against a forty-year Pawtucket, Rhode Island tradition of displaying a city owned creche, or nativity scene, in a private park owned by a non-profit organization.[308] Secular decorations of the holiday season, such as a Christmas tree, a Santa Clause house, reindeer pulling Santa's sleigh, and a host of cut-out figures, surrounded the creche.[309] Applying the *Lemon* test, the Court characterized the city's erection of the creche as having the secular purpose of depicting "the historical origins of this traditional event long recognized as a National Holiday."[310] Nor, the Court asserted, did including the creche in the display advance religion.[311] Instead of articulating this assumption, however, the Court simply noted the benefit to religion here was no greater than that conferred in other decisions, such as *Allen*, *Everson*, and *Roemer*.[312]

The dissenters, led by Justice Brennan, attacked the Court for characterizing the creche as a secular symbol representative of the holiday season.[313] The religious message necessarily present in the creche's very existence was not eliminated simply by surrounding it with secular holiday symbols.[314] In short, the presence of Rudolph and Santa in no way diminished the message of the creche—"that God sent His son into the world to become a Messiah."[315] Given the creche's irrefutable religious content, its placement by a public body, even on nonpublic land, benefitted religion and therefore violated the Establishment Clause.[316]

---

306. *Id.* at 276.
307. 465 U.S. 668 (1984). For criticisms of this decision, see Glenn S. Gordon, Lynch v. Donnelly: *Breaking Down the Barriers to Religious Displays*, 71 CORNELL L. REV. 185 (1985); Joshua D. Zarrow, *Of Crosses and Creches: The Establishment Clause and Publicly Sponsored Displays of Religious Materials*, 35 AM. U. L. REV. 477 (1986).
308. *Lynch*, 465 U.S. at 671.
309. *Id.*
310. *Id.* at 680.
311. *Id.* at 681-82.
312. *Id.*
313. *Id.* at 709 (Brennan, J., dissenting).
314. *Id.* at 708.
315. *Id.* at 711.
316. *Id.* at 695.

Four years later, *Allegheny County v. ACLU*[317] forced the Court to reckon with its decision in *Lynch*. Like *Lynch*, the dispute in *Allegheny County* involved a creche; unlike *Lynch*, however, it also involved a menorah.[318] Both symbols were situated on public property, but in different locales.[319] Yet, in an odd move, the Court required the county to remove the creche but allowed the menorah to remain. Placement of the creche on the "Grand Staircase" of the county courthouse sent the "unmistakable message that [the County] support[ed] and promot[ed] the Christian praise to God that is the creche's religious message."[320] Unlike the creche in *Lynch*, the one here was not surrounded by secular manifestations of the holiday season. Hence, the county had unconstitutionally endorsed religion.[321]

A group of dissenters characterized the Court's conclusion on the creche issue as "an unjustified hostility toward religion, a hostility inconsistent with our history and our precedents."[322] Following *Lynch*'s lead, Kennedy depicted the county as simply celebrating the season.[323] Given that the creche represented no real threat to religious liberty and that the county had not used its governmental power to further any Christian interests, he failed to see the rationale for its invalidity.[324]

Further entangling the decision was the menorah issue. Only two of the five Justices, Blackmun and O'Connor, who declared the creche unconstitutional believed the menorah to be constitutional. Three members of the majority consistently concluded that both violated the Establishment Clause. In contrast, the four dissenters, White, Rehnquist, Scalia, and Kennedy all thought both the menorah and the creche constitutional. Hence, it is Blackmun and O'Connor who accounted for the different outcomes.

In the majority opinion addressing the menorah, from which Brennan, Marshall, and Stevens, who had voted for holding the creche unconstitutional, dissented, the Court relied on two facts to support its holding. First, the menorah had a cultural as well as a religious message.[325] Therefore, acknowledging Chanukah as a secular holiday coincided with and was consistent with the tradition of celebrating Christmas as a secular holiday.[326] Second, the menorah was merely a component of a larger display which included a 45-foot Christmas tree.[327] As such, the tree predominated the display and overshadowed the 18-foot tall menorah, which served simply as a reminder "that

317. 492 U.S. 573 (1989).
318. *Allegheny County*, 492 U.S. at 578.
319. *Id.*
320. *Id.* at 579, 600.
321. *Id.* at 599-600.
322. *Id.* at 655 (Kennedy, J., dissenting). For a discussion of the numerous opinions in *Allegheny County*, see Barbara S. Barrett, *Religious Displays and the First Amendment*: County of Allegheny v. American Civil Liberties Union, 13 HARV. J.L. & PUB. POL'Y 399 (1990).
323. *Allegheny County*, 492 U.S. at 663.
324. *Id.* at 664-65.
325. *Id.* at 613-14.
326. *Id.* at 615.
327. *Id.* at 617.

Christmas is not the only traditional way of observing the winter-holiday season."[328]

O'Connor tacked a different approach but reached the same conclusion as the majority. Important to her, however, was a sign accompanying the menorah and tree exhibit which stated, "During this holiday season, the city of Pittsburgh salutes liberty. Let these festive lights remind us that we are the keepers of the flame of liberty and our legacy of freedom."[329] The city's erection of the menorah, therefore, constituted not an endorsement of religion but rather a "message of pluralism and freedom."[330] Hence the distinction between the religious message inherent in the creche and the political message attendant to the menorah serves to reconcile O'Connor's seemingly inconsistent opinions.

V. RECENT ESTABLISHMENT CLAUSE DECISIONS

A. Capitol Square Review & Advisory Board v. Pinette[331]

Capitol Square, handed down on the last day of the Court's 1995 term, was despite its dissentious features an easy case. Indeed, it was the nature of the facts rather than the constitutionality of the action which created a hotbed of controversy. At the heart of the debate was the appropriate use of Capitol Square, a 10-acre public plaza encircling the Columbus, Ohio statehouse.[332] The Square enjoyed a century old history as a public forum for "free discussion of public questions, or for activities of a broad purpose."[333] To regulate access to the forum, Ohio law vested control over the permit process to the Capitol Square Review Board (Board), which traditionally allowed broad access and diverse groups to conduct events in the Square.[334] In late November 1993, the Board acted on two applications.[335] It granted one, denied the other.[336] The application approved permitted a rabbi to erect a menorah.[337] The application denied prevented the Klan from erecting a cross.[338] To substantiate its denial of the Klan's application, the Board cited both the Ohio and United States Constitutions.[339]

After an unsuccessful attempt to procure administrative relief, the Klan's leader, Vincent Pinette, sued the Board in federal district court.[340] Despite the Board's assertion that the Establishment Clause prevented it from permitting the Klan to display its cross, that court issued an injunction requiring the

328. *Id.*
329. *Id.* at 635 (O'Connor, J., concurring).
330. *Id.*
331. 115 S. Ct. 2440 (1995).
332. *Capitol Square*, 115 S. Ct. at 2444.
333. *Id.*
334. *Id.*
335. *Id.* at 2445.
336. *Id.*
337. *Id.*
338. *Id.*
339. *Id.*
340. Capitol Square Review & Advisory Bd. v. Pinette, 844 F. Supp. 1182 (S.D. Ohio 1993).

Board to grant the permit.[341] In support of its decision the district court weighed heavily both the First Amendment protection accorded free speech and the lack of evidence indicating that display of the cross constituted state endorsement of religion.[342] On appeal, the Sixth Circuit affirmed.[343] Hence, the Klan's cross went on display in Capitol Square.[344]

Although the 1993-94 Holiday season came and went, the Capitol Square dispute lingered until June 29, 1995, when a 7-2 Supreme Court affirmed the lower courts' decisions. The Court, however, proved incapable of reaching a consensus as to the rationale underlying its conclusion. Rather, the fragmented Court could produce only a plurality opinion, as well as three rounds of concurrences and two dissents. Justice Scalia spoke for the four member plurality, which also included Chief Justice Rehnquist, and Justices Kennedy and Thomas.[345] At the outset, he rejected the Klan's attempt to recharacterize the issue not as one regarding establishment of religion but as one regarding content-based speech discrimination. The Court, Scalia remarked, would hear the case as the lower courts decided it and the parties presented it.[346] Hence, the sole issue for decision was that pertaining to the Establishment Clause.[347]

The Board's decision to ground the Klan's denial in the Establishment Clause proved in hindsight to be cataclysmic. As the plurality noted, the Klan's display constituted private expression subject to the full protection of the First Amendment's Free Speech Clause.[348] Moreover, because Capitol Square constituted a public forum, the Board could prohibit protected conduct, such as the Klan's, only if the restriction was narrowly drawn to serve a compelling state interest.[349] Although the Court agreed with the Board that compliance with the Establishment Clause constituted a compelling state interest, it refused to characterize the Klan's attempt to erect a cross in a traditional public forum as an act prohibited by the Establishment Clause.[350] To this end, it adopted a per se rule of constitutionality for religious expression which is "(1) purely private and (2) occurs in a traditional or designated public forum, publicly announced and open to all on equal terms."[351]

In reaching this conclusion, the Court relied on *Lamb's Chapel* and *Widmar*, noting that in both it rejected identical Establishment Clause defenses because of the variety of the forum's uses, the lack of direct sponsorship of the questioned activity, and the incidental benefit conferred upon the particular religious group.[352] Despite the obvious similarities, the Board forced the

341. *Id.* at 1188.
342. *Id.* at 1186-88.
343. Capitol Square Review & Advisory Bd. v. Pinette, 30 F.3d 675 (6th Cir. 1994).
344. *Capitol Square*, 115 S. Ct. at 2445.
345. *Id.* at 2440.
346. *Id.* at 2445.
347. *Id.*
348. *Id.* at 2446.
349. *Id.* In the absence of such an interest, the Board could only impose reasonable time, place, and manner restriction. *Id.*
350. *Id.* at 2446-50.
351. *Id.* at 2450.
352. *Id.* at 2447.

Court to address one distinguishing characteristic—the Square's proximity to the statehouse.[353] In essence, the Board maintained the Court should find the restriction constitutional because observers could conceivably mistake the Klan's expression as a religious message supported and endorsed by the state.[354] The Court in response noted simply, "We find it peculiar to say that government promotes or favors a religious display by giving it the same access to a public forum that all other displays enjoy."[355]

The plurality opinion sparked a variety of responses. Although Justice Thomas agreed with and joined in the plurality's opinion, he wrote separately to denote that the Klan's expression was essentially and indisputably political rather than religious.[356] Nonetheless, because the Board presented an Establishment Clause defense, the Court decided the case applying Establishment Clause jurisprudence.[357] In contrast, O'Connor, who did not join the plurality, emphasized her discontent with the plurality's characterization of the appropriate jurisprudential standard and its adoption of a per se rule.[358] In addition, she believed it important that the display bear a sign disclaiming government sponsorship of the exhibit.[359]

For his part, Souter wrote to degrade the per se rule, which he characterized as an irrebuttable presumption, and to reinforce the perhaps forgotten ability of the Board to ban all unattended displays in the Square.[360] Another apparent danger Souter feared was that while on the Square the cross "would have been the only private display on the public plot."[361] Despite the Board's legitimate apprehensions, however, Souter felt its response inappropriate.[362] Rather than simply banishing the display altogether, Souter argued, the Board should either have required the Klan to post a disclaimer or banned all unattended displays from the square.[363] Because it opted for neither of these alternatives, it could not in good faith claim the display endorsed any religious message inherent in the Klan's cross.[364]

In dissent, Justice Stevens advocated a bright-line rule which "created a strong presumption against the installation of unattended religious symbols on public property."[365] Stevens considered the unattended displays in *Capitol Square* to be of a fundamentally different nature than the private speakers in both *Lamb's Chapel* and *Widmar*.[366] Unattended displays inherently convey a

353. *Id.*
354. *Id.*
355. *Id.* The Court further distinguished *Allegheny County* and *Lynch*, two previous display cases the Board relied upon, by noting that those cases involved, respectively, unequal access to the forum and a display which did not endorse religion. *Id.* at 2448.
356. *Id.* at 2450 (Thomas, J., concurring).
357. *Id.* at 2447-50.
358. *Id.* at 2451, 2454 (O'Connor, J., concurring in part).
359. *Id.* at 2453.
360. *Id.* at 2457, 2459 (Souter, J., concurring in part).
361. *Id.* at 2461.
362. *Id.*
363. *Id.* at 2461-62.
364. *Id.* at 2462.
365. *Id.* at 2464 (Stevens, J., dissenting).
366. *Id.* at 2471.

message which, unlike oral speech, cannot be disassociated from the state, and in fact can be reasonably perceived as state endorsement of the expression. Indeed, "when a statue or some other freestanding, silent, unattended immoveable structure—regardless of its particular message—appears on the lawn of the Capitol building, the reasonable observer must identify the State either as the messenger, or at the very least, as one who has endorsed the message."[367] Hence, in Stevens's view, a public body which permitted any group to erect unattended religious displays on public property violated the fundamental principles enshrined in the Establishment Clause.

Problems abound in Stevens's approach. Foremost among these is its hostility towards religious speech. For example, under Stevens's framework, only unattended *religious* displays are prohibited. Exhibits erected for any other motive, no matter how unpopular or distasteful, are allowed. This result is rendered even more absurd when one considers the preeminent protection afforded religious expression under the Free Exercise Clause. Yet Stevens would bestow upon the state the power to exclude "unattended symbols when they convey a type of message with which the state does not wish to be identified."[368] Perhaps Stevens overlooks that the First Amendment protects all speech, not simply that which happens to conform with a given public body's perception of the appropriate. At one point, Stevens noted, "I think it obvious, for example, that Ohio could prohibit certain categories of signs or symbols in Capitol Square—erotic exhibits, commercial advertising, and perhaps campaign posters as well—without violating the Free Exercise Clause."[369] In short, Stevens attempted singlehandedly to relegate a vital facet of private religious speech "to a realm heretofore inhabited only by sexually explicit displays and commercial speech."[370] As Scalia pointedly concluded, however, "It will be a sad day when this Court casts piety in with pornography, and finds the First Amendment more hospitable to private expletives than to private prayers."[371]

---

367. *Id.* at 2467.
368. *Id.* at 2468.
369. *Id.*
370. *Id.* at 2449.
371. *Id.* Professor Rodney Blackmun describes why protection of religious speech is critical to American democracy:

> Religious discourse is a form of speech, and religious activity and practice, even if not considered forms of speech, are found in primitive and advanced states alike. The reason why religious activity is so ubiquitous is because it fills needs. Humans tend to seek answers to ultimate questions: Why am I here? What is the meaning of life? How should I relate to other living creatures and nature itself? How did life develop? How should I act? Is there any life to which I can aspire that transcends this earthly one? Is it an innate aspect of the human psyche to engage in religious speculation, or is it a reflection of our collective state of ignorance that will become stated in time when science can supply more answers to basic questions? Either way, the centrality of religious thought and practice to much of humankind cannot be easily denied. If our democratic state is to exist for the fulfillment of human needs, then this religious expression and practice must be regarded as a very important value to be protected along with other forms of speech.

Rodney J. Blackmun, *Showing the Fly the Way Out of the Fly-Bottle: Making Sense of the First Amendment Religion Clauses*, 42 U. KAN. L. REV. 285, 287-88 (1994).

B. Rosenberger v. Rector & Visitors of the University of Virginia[372]

Rosenberger, unlike *Capitol Square*, involved a novel Establishment Clause issue: whether a university which provided payments to outside contractors for various student group expenses could refuse payment because a student paper "primarily promot[ed] or manifest[ed] a particular belie[f] in or about a deity or ultimate reality."[373] Perhaps Justice O'Connor best characterized the dilemma confronting the court as one "at the intersection of the principle of government neutrality and the prohibition on state funding of religious activities."[374]

The University of Virginia (University), in an attempt to "enhance the University environment,"[375] allowed various student groups to apply for funding distributed from the Student Activities Fund (SAF), which was comprised and replenished by a mandatory fee of $14 per student per semester.[376] University guidelines charged the student council with responsibility for distributing SAF resources, and further required that in lieu of direct payments to the particular student groups, the council should reimburse the group's creditors directly.[377] Funding, however, was not automatic. In fact, only those groups who first obtained CIO, or Contracted Independent Organization status, were eligible for consideration.[378] Importantly, University policy excluded religious organizations from achieving CIO status.[379]

In 1990, Rosenberger, the complainant, formed Wide Awake Productions, or WAP, to publish a school paper dedicated to "challeng[ing] Christians to live, in word and deed, according to the faith they proclaim and to encourage students to consider what a personal relationship with Jesus Christ means."[380] Despite this mission, the University awarded WAP CIO status, evidencing it did not consider WAP a religious organization.[381] Nonetheless, the Appropriations Committee, as did all subsequent University bodies, denied WAP's request that $5862 be paid to its printer for expenses associated with printing its publication.[382] The committee based its denial on WAP's University prohibited status as a religious activity in that "the newspaper promoted or manifested a particular belief in or about an ultimate deity."[383] Unwilling to be subjected to what he considered blatant religious discrimination, Rosenberger (and WAP) filed suit in district court, alleging violations of their free speech, free press, and free exercise rights, as well as their right to equal protection of the law.[384] The district court entered summary judgment against WAP, citing the

372. 115 S. Ct. 2510 (1995).
373. *Rosenberger*, 115 S. Ct. at 2513.
374. *Id.* at 2525 (O'Connor, J., concurring).
375. *Id.* at 2514.
376. *Id.*
377. *Id.* at 2414-15.
378. *Id.* at 2514.
379. *Id.* at 2515.
380. *Id.*
381. *Id.* University Guidelines defined a religious organization as one "whose purpose is to practice a devotion to an acknowledged ultimate reality or deity." *Id.*
382. *Id.*
383. *Id.*
384. Rosenberger v. Rector & Visitors of the Univ. of Va., 759 F. Supp. 175, 176-78 (W.D.

Establishment Clause as a bar to releasing the funds.[385] After the Fourth Circuit affirmed, Rosenberger filed for and was granted certiorari. In a narrow 5-4 decision, the Supreme Court reversed.

The majority, led by Justice Kennedy, characterized the SAF as a forum for speech purposes and found that its refusal to authorize the reimbursement was a form of invidious viewpoint discrimination.[386] In depicting the restriction as one which restricted only "those student journalistic efforts with religious editorial viewpoints," the Court noted the skewing effect on the marketplace of ideas.[387] To this end, the Court relied on its conclusion in *Lamb's Chapel*, where it held that a school's refusal to permit a religious group access to show a Christian film constituted viewpoint discrimination.[388] In an attempt to evade this already stretched *Lamb's Chapel* rationale, the University asserted that funds were fundamentally different from facilities.[389] In short, the University argued funds are scarce, facilities are not.[390] The Court in response turned the University's argument on its head and remarked that under this premise the University could engage in viewpoint discrimination in the *Lamb's Chapel* context if physical space exceeded money.[391] Because the Establishment Clause forbad such discrimination, the University could likewise not justify its viewpoint discrimination on economic scarcity grounds.[392] Finally, the Court feared the broad sweep of the University's restriction, noting that if pressed to its bounds it could preclude "funding of essays by hypothetical student contributors named Plato, Spinoza, and Descartes."[393] Moreover, because the prohibition applied to atheists as well, the policy would preclude the writings of Karl Marx, Bertrand Russell, and Jean-Paul Sartre.[394] Given these concerns, the University's refusal to allow Rosenberger and WAP to participate in SAF funding constituted a denial of their free speech rights.[395]

This free speech protection, however, would be trumped if the University could demonstrate that the Establishment Clause mandated its restriction.[396] Unfortunately for the school, the Court held the Establishment Clause imposed no such prohibitions, and then characterized the SAF program as one emanating neutrality and evenhandedness.[397] Rather than seeking to advance religion, the program's object was "to open a forum for speech and to support various student enterprises, including the publication of newspapers, in recognition of the diversity and creativity of student life."[398] Nor, the Court

---

Va. 1992).

385. *Id.* at 182-83.
386. *Rosenberger*, 115 S. Ct. at 2517.
387. *Id.* at 2517-18.
388. *Id.* at 2517.
389. *Id.* at 2519.
390. *Id.*
391. *Id.*
392. *Id.*
393. *Id.* at 2520.
394. *Id.*
395. *Id.*
396. *Id.*
397. *Id.* at 2521-22.
398. *Id.* at 2513.

opined, could the program be construed as University endorsement of religion, especially given the extensive measures and disclaimers the school required CIOs to implement.[399]

The final card played by the majority tendered the indisputable fact that no funds flowed directly to WAP.[400] Although the Court conceded the expenditure of funds, it preferred to focus upon the nature of the benefit WAP received. In this respect, the SAF program did not differ from one in which the University provided eligible student groups access to its printing services.[401] Indeed, when viewed in this light, religion benefitted only incidentally.[402]

In her concurrence, Justice O'Connor articulated several reasons for her decision, noting first the independence maintained between the student groups and the University.[403] Because school guidelines required explicit disclaimers, readers of WAP were on notice that it was not a University sponsored publication.[404] Second, the mechanism by which the University distributed funds ensured no impermissible uses.[405] To this end, O'Connor characterized the situation as analogous to one where the school simply made available on an equal basis a printing press for student use.[406] Third, the numerous publications, in addition to WAP, funded by SAF served to decrease the likelihood that readers would perceive the University as endorsing the publication's religious message.[407] Finally, O'Connor reasoned the possibility that a dissenting student could refuse to pay into the fund protected the fee from a Free Speech Clause challenge and ensured few disputes over the issue of religious funding.[408]

Justice Thomas, who agreed with the Court's opinion, wrote only to disagree with the dissent's historical conclusions.[409] In short, the dissenters, led by Souter, offered Madison's *Remonstrance* as evidence that the Establishment Clause necessitated the University's SAF restriction.[410] Unfortunately, Souter mischaracterized and distorted the *Remonstrance* in an attempt to render it applicable to the issue at hand. The *Remonstrance* involved an assessment to support Christian teachers; unlike the exaction upon the students here, it did not involve using a common pool fund to bestow, on a neutral basis, benefits to a variety of institutions without regard to secular or sectarian viewpoints. As such, the tax which prompted the *Remonstrance* was of a different nature than the "tax" imposed in *Rosenberger*.[411] Following this historical

---

399. *Id.* at 2523.
400. *Id.*
401. *Id.* at 2524.
402. *Id.*
403. *Id.* at 2526 (O'Connor, J., concurring).
404. *Id.* at 2527.
405. *Id.*
406. *Id.*
407. *Id.*
408. *Id.* O'Connor's emphasis on this point lacks substance, however, because there was no mechanism through which an objecting student could receive a pro-rata reimbursement.
409. *Id.* at 2528 (Thomas, J., concurring).
410. *Id.* at 2535-36 (Souter, J., dissenting).
411. After discussing the *Remonstrance*, Souter proceeded to cite the Virginia Bill. *Id.* at

discussion, the dissenters ridiculed the Court's reliance on the channel through which the funds flowed and its characterization of the restriction as viewpoint rather than content discrimination.[412] Indeed, in Souter's mind, the Court for the first time, and in direct contravention of convincing Establishment Clause jurisprudence, upheld "direct core funding of core religious activities by an arm of the state."[413]

In short, *Rosenberger* posed an unusual issue for decision. In this respect many would contend Souter's dissenting opinion simply lends credence to the homage that hard cases make bad law. Unfortunately, *Rosenberger* does not fall into this category. Its facts were straightforward, the inequitable effect on WAP obvious. Yet the dissent consisted of unrealistic and unfounded assumptions regarding the threat posed to religious freedom by the alleged Establishment Clause breach. Even more upsetting is Souter's failure to mention the University's unabashed double-standard with respect to funding publications of a religious nature. In fact, nowhere does the dissent, which critically perused WAP's publication for a Christian message, note that the "University has provided support to The Yellow Journal, a humor magazine that has targeted Christianity as a subject of satire, and Al-Salam, a publication 'to promote a better understanding of Islam to the University Community.'"[414] Indeed, only Justice O'Connor recognized the Court was treading new ground and acknowledged the inadequacy of strict reliance on precedent. Unlike the dissenters, however, the majority, including O'Connor, proved willing to make an equitable decision based on a thorough understanding of what government neutrality entails.[415]

VI. ANALYSIS OF THE COURT'S ESTABLISHMENT CLAUSE JURISPRUDENCE

Rosenberger and *Capital Square* represent the culmination of the Court's inability to delineate a workable Establishment Clause framework. In addition, the decisions exemplify the frustration engendered between the Justices with respect to which, if any, framework is worthy of selection and application. Consider the legal landscape before *Rosenberger* and *Capital Square*. The *Lemon* test, which was twenty-four years in the making before its explicit adoption in 1971, was considered an unabashed failure, having lingered on uselessly for twenty-five years after its creation. Yet despite the criticism heaped on *Lemon* from courts and commentators, the Court had not expressly

---

2536-37. Unfortunately, he conveniently overlooked the Bill's religious presumptions and its historical context as one of many Virginia laws passed by Madison and Jefferson which dabbled in religious matters. *See infra* notes 488-90 and accompanying text.

412. *Rosenberger*, 115 S. Ct. at 2544, 2549-50.

413. *Id.* at 2533.

414. *Id.* at 2527 (O'Connor, J., concurring).

415. For more detailed discussions of *Rosenberger*, see Ralph D. Mawdsley & Charles J. Russo, *Religion in Public Education:* Rosenberger *Fuels an Ongoing Debate*, 103 ED. LAW REP. 13 (1995) (arguing that *Rosenberger* was merely the culmination of an equal access movement that began with *Widmar* and included *Mergens* and *Lamb's Chapel*); David Schimmel, *Discrimination Against Religious Viewpoints Prohibited in Public Colleges and Universities: An Analysis of* Rosenberger v. The University of Virginia, 102 ED. LAW REP. 911 (1995) (maintaining that *Rosenberger*'s legal impact upon Establishment Clause jurisprudence will be limited and narrow).

repudiated it. Nonetheless, the Court had not applied the test in any of its Establishment Clause decisions rendered in the last two terms. Instead, it had simply ignored, as it for the most part did in *Rosenberger* and *Capitol Square*, *Lemon*'s existence. Failure to formally repudiate *Lemon* did not, however, prevent the Court from continuing its dialogue over what framework should replace the admittedly defunct *Lemon* test. Undoubtedly, as *Capitol Square* and *Rosenberger* evidence, unanimity in this respect is not likely to occur in the near future. Consider that in these two cases alone, the Justices proffered at least three different tests: O'Connor's endorsement test, the per se test applied in *Capitol Square*, and the historical test of the Rehnquist, Scalia, Kennedy, and Thomas wing. Although the survival of any of these tests is tenuous and speculative at best, it at long last appears that the Justices agree that *Lemon*'s limited utility does not justify its continued application. In this respect the following discussion traces *Lemon* from its inception to its demise. The critique then turns to the educational arena, where the Court reaped the inconsistent results sowed from its endorsement of separationism and its adoption of *Lemon*. The reasons for these failures, inattentiveness to, and ignorance of, history, are then discussed. In short, *Lemon* failed because it, like most of the Court's Establishment Clause jurisprudence, is based on inaccurate history. To this end, the discussion attempts to characterize the views of Madison, Jefferson, and the other Framers and Founders in a fair, and often overlooked, historical light. This historical misinterpretation is itself based on the Court's most fundamental mistake—its incorporation of the Establishment Clause and its subsequent application to the states. This analysis proffers that the incorporation decision, and the Court's subsequent attempts to use originalist, Framers' intent to justify its regulation of even-handed, nonpreferential state actions with respect to religion is inapposite to the Clause's inherent federalism component and is therefore the root of the Court's inability to render equitable and historically supported Establishment Clause decisions.

A. *The Failure of the* Lemon *Test and the Fruitless Search for Workable Standards*

The Court's Establishment Clause jurisprudence is, to say the least, a mess. Sadly, even the Justices themselves acknowledge the "hopeless disarray" which permeates the inconsistent stack of "embarrassing" Supreme Court Establishment Clause announcements.[416] Much of the turmoil can be traced to the Court's resolute adherence to the maligned *Lemon* test. Fortunately, there has been in recent years a strident shift away from this jurisprudence in which inconsistency was the only hallmark.[417]

---

416. *See, e.g.*, *Rosenberger*, 115 S. Ct. at 2532 (Thomas, J., concurring); Edwards v. Aguillard, 482 U.S. 578, 639 (1987) (Scalia, J., dissenting). Note that since *Everson* the Court has decided at least 140 Establishment Clause decisions. *See* Stuart D. Poppel, *Federalism, Fundamental Fairness, and the Religion Clauses*, 25 CUMB. L. REV. 247 (1995).

417. In *Aguillard*, Justice Scalia had the following to say about the effect of *Lemon* upon the Court's Establishment Clause doctrine:

Chief Justice Rehnquist, the ringleader of the *Lemon* malcontents, initiated the shift away from the historically baseless test in 1985. There, in *Wallace v. Jaffree*,[418] he voiced discontent with both the purpose and entanglement prongs. The purpose element, he noted, was particularly useless given the Court's acceptance of virtually every legislature's proffered secular purpose.[419] Such pretextual inquires unnecessarily tempted legislators to simply express a secular purpose so as to ensure compliance with the purpose prong.[420] In contrast, the entanglement element created the "insoluble paradox" of requiring public officials to closely monitor parochial schools under the purpose or effect prongs, yet at the same time concluded that overarching supervision created an unconstitutional entanglement.[421]

Justice O'Connor, although a newcomer to the Court, also expressed doubts about *Lemon*'s usefulness in *Wallace*.[422] Nonetheless, she argued for its retention in hope that the Court could refine *Lemon* so as to ensure it not only reflected accurate historical interpretation but "also proved capable of consistent application."[423] She further lobbied for adoption of her view, expressed the year before in *Lynch v. Donnelly*,[424] that the "Establishment Clause is infringed when the government makes adherence to religion relevant to a person's standing in the political community."[425] This determination, O'Connor further asserted, required the Court to determine, under *Lemon*'s purpose and effect prongs, "whether government's purpose is to endorse religion and whether the statute actually conveys a message of endorsement."[426]

In 1987, Scalia jumped on the anti-*Lemon* bandwagon by not only characterizing the test as having no basis in history and yielding unprincipled

---

> Our cases interpreting and applying the purpose test have made such a maze of the Establishment Clause that even the most conscientious governmental officials can only guess what motives will be held unconstitutional. We have said essentially the following: Government may not act with the purpose of advancing religion, except when forced to do so by the Free Exercise Clause (which is now and then); or when eliminating existing governmental hostility to religion (which exists sometimes); or even when merely accommodating governmentally uninhibited religious practices, except that at some point (it is unclear where) intentional accommodation results in the fostering of religion, which is of course unconstitutional.

Aguillard, 482 U.S. at 636.

418. 472 U.S. 38 (1985).

419. *Wallace*, 472 U.S. at 108 (Rehnquist, J., dissenting). The purpose prong posed other problems as well. For instance, courts frequently held that the purpose prong reflected the erroneous assumption that the "Establishment Clause imposes a constitutional disability on religion . . . rather than a protection of religious liberty." Michael S. Paulsen, Lemon *Is Dead*, 43 CASE W. RES. L. REV. 795, 801 (1993). The purpose prong thus "misleadingly implied (and many courts thus held) that laws motivated by a desire to promote religious freedom or to accommodate religious practice automatically constitute an Establishment Clause violation." *Id.*

420. *Wallace*, 472 U.S. at 108.

421. *Id.* at 109. The entanglement prong was under increasing fire; in *Aguilar v. Felton*, Justice O'Connor boldly stated, "I question the utility of entanglement as a separate Establishment Clause standard in most cases." Aguilar v. Felton, 473 U.S. 402, 422 (1985) (O'Connor, J., dissenting).

422. *Wallace*, 472 U.S. at 67 (O'Connor, J., concurring).

423. *Id.* at 69.

424. 465 U.S. 668, 687 (1984) (O'Connor, J., concurring).

425. *Wallace*, 472 U.S. at 69 (O'Connor, J., concurring).

426. *Id.*

results,[427] but also by advocating that the Court abandon the purpose element entirely.[428] By the time the Court decided *Lamb's Chapel* six years later, Scalia, and Thomas and Rehnquist along with him, were advocating that the Court scrap *Lemon* completely.[429] To this extent, Scalia forcefully advised, "I will decline to apply *Lemon*—whether it validates or invalidates the government action in question—and therefore cannot join the opinion of the Court today."[430] His remarks regarding *Lemon* were justifiably hostile:

> The secret of the *Lemon* test's survival, I think, is that it is so easy to kill. It is there to scare us (and our audience) when we wish it to do so, but we can command it to return to the tomb at will. When we wish to strike down a practice it forbids, we invoke it; when we wish to uphold a practice it forbids, we ignore it entirely. Sometimes we take a middle course, calling its three prongs "no more than helpful signposts." Such a docile and useful monster is worth keeping around, at least in a somnolent state; one never knows when one might need him.[431]

Indeed, as Scalia noted, a majority of the current Justices had personally condemned the test in one form or another, but the Court as a whole, despite numerous opportunities, had never specifically repudiated it.[432]

The 1994 *Kiryas Joel* decision marked the turning point in the efforts of Rehnquist, Thomas, Kennedy, Scalia, and O'Connor to rid Establishment Clause jurisprudence from *Lemon*'s sour effects. Although the Court did not, and has not, specifically countenanced that *Lemon*'s days are over, it has not applied the test in any case decided since 1993. In *Kiryas Joel*, only Justice Blackmun clung to the principles enunciated in *Lemon*.[433]

This trend away from *Lemon* continued in 1995 in both *Rosenberger* and *Capitol Square*. Noticeably, the *Capitol Square* plurality (Rehnquist, Scalia, Kennedy, and Thomas) applied neither *Lemon* nor O'Connor's increasingly popular endorsement test. Rather, it created the per se rule described above. Not surprisingly, O'Connor, joined by Souter and Breyer, advocated the endorsement test. In the unattended display context, O'Connor argued, endorsement would occur if a reasonable observer, knowledgeable of the "history and context of the community and the forum in which the religious display exists,"[434] would believe the display to be endorsed by the state. Justice

---

427. Edwards v. Aguillard, 482 U.S. 578, 636 (1987) (Scalia, J., dissenting).

428. *Id.* at 640.

429. Lamb's Chapel v. Center Moriches Union Free Sch. Dist., 113 S. Ct. 2141, 2149 (1993) (Scalia, J., concurring).

430. *Id.* at 2150.

431. *Id.* (citations omitted).

432. *Id.*

433. Board of Education of Kiryas Joel Village Sch. Dist. v. Grumet, 114 S. Ct. 2481, 2494-95 (Blackmun, J., concurring). Scalia, while disagreeing with the Court's *Kiryas Joel* decision, wholeheartedly supported its "snub" of the *Lemon* test. *Id.* at 2515 (Scalia, J., dissenting). He correctly pointed out, however, the difficulties the Court imposes by not specifically denouncing the test. For example, the *Kiryas Joel* parties produced over 80 pages of briefs devoted solely to the test's principles. *Id.*

434. *Capitol Square*, 115 S. Ct. at 2455.

Stevens also applied the endorsement test but differed with O'Connor over the proper level of knowledge the Court should attribute to the reasonable observer.[435]

The *Rosenberger* Court, like the *Capitol Square* Court, was dominated by the Rehnquist, Scalia, Kennedy, and Thomas wing. Hence it ignored both *Lemon* and the endorsement test, which O'Connor loyally and steadfastly defended.[436] Instead, Justice Kennedy characterized the necessary inquiry as "one into the purpose and object of the governmental action in question and . . . into the practical details of the program's operations."[437] Kennedy's opinion also emanated nonpreferentialist tendencies, noting at one point that "the apprehensions of our predecessor involved the levying of taxes upon the public for the sole and exclusive purpose of establishing and supporting specific sects."[438] To this end, the Souter dissent, perhaps too secure in the Court's historical separationism, admonished that the nonpreferential battle was waged and lost long ago.[439] Perhaps Souter is ignorant to the Scalia wing's intent to replace separationism with nonpreferentialism. In any event, it will be neither Scalia nor Souter, but O'Connor who will determine the direction of the Court's Establishment Clause jurisprudence.[440]

The very real possibility is that regardless of the test applied, Establishment Clause cases will inevitably yield inconsistent decisions. Sadly, even a Supreme Court Justice has admitted that the only guiding source in this jurisprudential area is the Justices' personal and political views.[441] One commentator reaches precisely this result:

> If the Court should repudiate the test . . . it would surely employ similar considerations . . . . Moreover, tests have little to do with decisions; the use of a test lends the appearance of objectivity to a judicial opinion, but no evidence shows that a test influences a member of the Court to reach a decision he or she would not have reached without that test. And Justices using the same test often arrive at contradictory results.[442]

---

435. *Id.* at 2466 n.5 (Stevens, J., dissenting).

436. *See Rosenberger*, 115 S. Ct. at 2526.

437. *Id.* at 2521.

438. *Id.* at 2522.

439. *Id.* at 2537 n.1 (Souter, J., dissenting).

440. As *Rosenberger* depicts, Rehnquist, Scalia, Kennedy, and Thomas will continue to support nonpreferentialism; likewise, Souter, Stevens, Ginsburg, and Breyer are undoubtedly separationist. Hence, O'Connor and her endorsement test will tack the Court's Establishment Clause future. Note that O'Connor's endorsement tests are, for the most part, well received by scholars. For a critique of the test, see Matthew S. Steffey, *The Establishment Clause and the Lessons of Context*, 26 RUTGERS L.J. 775 (1995) (maintaining that the endorsement test is correct in its focus on the context of the dispute).

441. Justice Jackson observed:

> It is idle to pretend that this task is one for which we can find in the Constitution one word to help us as judges to decide where the secular ends and the sectarian begins . . . . Nor can we find guidance in any other legal source. It is a matter on which we can find no law but our own prepossessions.

McCollum v. Board of Education, 333 U.S. 203, 237-38 (1948) (Jackson, J., concurring)

442. LEVY, *supra* note 9, at 156.

In this respect, consider that even though the bell has tolled for *Lemon*, disputes are already arising over the scope of the endorsement test.[443]

B. *The Education Mess*

1. Private Education

Nowhere has the effects of the Court's inability to articulate a standard been more profound than in the sphere of education. Consider that the Court decided many of these cases before it delineated the *Lemon* test. As such, it was forced to conform or distinguish those pre-*Lemon* decisions once it articulated the *Lemon* test. Moreover, education cases crop up with such frequency that in many instances the Court has not even applied the *Lemon* test when resolving an Establishment Clause dispute over education. In short, the disputes have outlived the test that was designed to resolve them. The result is a sphere of Establishment Clause jurisprudence which is distorted and filled with meaningless distinctions.

This unfortunate byproduct is especially true in the context of aid to parochial schools, where time and again the Court has reiterated that the Establishment Clause permits incidental benefits and does not preclude religious schools and their students from partaking in neutral government benefit programs. Yet even a cursory analysis of its decisions belies this assertion. Consider in this respect Chief Justice Rehnquist's lengthy but pointed summary of the Court's aid to parochial school decisions:

> [A] State may lend to parochial school children geography textbooks that contain certain maps of the United States, but the State may not lend maps of the United States for use in geography class. A State may lend textbooks on American colonial history, but it may not lend a film on George Washington, or a film projector to show it in history class. A State may lend classroom workbooks, but may not lend workbooks in which the parochial school children may write, thus rendering them nonreusable. A State may pay for bus transportation to religious schools, but may not pay for bus transportation from the parochial school to the public zoo or natural history museum for a field trip. A State may pay for diagnostic services conducted in the parochial school but therapeutic services must be given in a different building; speech and hearing "services" conducted by the State inside the sectarian school are forbidden, but the State may conduct speech and hearing diagnostic testing services inside the sectarian school. Exceptional parochial school students may receive counseling, but it must take place outside of the parochial school, such as in a trailer parked down the street. A State may give cash to a parochial school to pay for the administration of state-written tests and state-ordered

---

443. Note also that *Lemon* still has some, if few, supporters. In this vein, see Carol F. Kagan, *Squeezing the Juice from* Lemon: *Toward a Consistent Test for the Establishment Clause*, 22 N. KY. L. REV. 621 (1995) (arguing that a modified *Lemon* test provides a suitable framework for Establishment Clause jurisprudence).

> reporting services, but it may not provide funds for teacher-prepared tests on secular subjects. Religious instruction may not be given in public school, but the public school may release students during the day for religion classes elsewhere, and may enforce attendance at those classes with its truancy laws.[444]

Simply put, the Court has become mired in separationist dogma and consequently lost sight of the children disadvantaged by its decisions.[445] Although the separationist fear[446] is understandable, none of the above situations, considered either individually or cumulatively, bestow upon religious schools a substantial, direct financial gain. Indeed, all the benefits Justice Rehnquist summarized are unrelated to the schools' religious emphasis and for the most part unadaptable to sectarian purposes.[447]

A second and equally divisive concern in the parochial school arena constitutes the appropriateness of providing tax relief to parents of children who attend parochial school. Undoubtedly, these parents "bear a particularly great financial burden in educating their children."[448] They are not, as many claim, double taxed, because taxes by their nature are mandatory while parochial school attendance is not. Yet parents of parochial school children contribute greatly to the maintenance of public schools. By contributing through taxes to the health of the public education system but sending their children to parochial schools, these parents effectively subsidize the education of public school students. Hence, those adverse to tax credits or exemptions for parents of parochial school students would do well to consider the resultant strain on both the public education system and the public coffers should enrollment in nonpublic schools vastly decline. Consider that if the number of private school students were to decrease and the pool of public school students necessarily increase, the per student expenditures for public school students would fall dramatically, thereby drastically reducing the quality of public school education. When considered in this light, the effect of a paltry tax credit, deduction, or exemption is negligible at most.

---

444. Wallace v. Jaffree, 472 U.S. 38, 110-11 (1985) (Rehnquist, J., dissenting) (citations omitted).

445. One commentator states that an unduly rigid separationism affects American society, not just schoolchildren, in drastic ways. Lupu, *supra* note 188, at 279. Lupu posits, in fact, that strong separationism favored irreligion by advocating secular rationality, which is in turn partial to a particular set of institutions. *Id.* Nor "is secular rationality particularly conducive to the life of the spirit, without which it may not be possible for a nation to thrive." *Id.*

446. Separationists are concerned not that religious schools will lead to a formal establishment but rather that the more substantive and direct the aid becomes, the less the schools resemble religious schools and the more they resemble public schools which merely emphasize religion. While one could conceive of situations where this could occur, e.g., if public funds were used to pay religious school teacher's salaries, none of the parochial school aid cases discussed posed any real threat of such an egregious effect.

447. Levy resolved the issue as follows: "If proper restraints exist on the funds for parochial schools so that tax monies are not spent for religious purposes and the aid rendered is comparable to the value of the secular education provided by the schools, fairness again seems to be on the accommodationist side." LEVY, *supra* note 9, at 179.

448. Mueller v. Allen, 463 U.S. 388, 402 (1983).

2. Public Education

An unfortunate side effect of both the Court's rulings and strict-separationist pressure has been the ability of overzealous public interest lawyers[449] to threaten school boards with litigation, and thereby frighten them into submission and foreclose all discussion of religion in the public school curriculum.[450] This does not have to be so. The Establishment Clause prohibits only those interactions between public schools and religion which are designed with a religious purpose to reap benefits for a religion or a religious sect. The Establishment Clause does not and could not prohibit discussion of religious literature or the instruction of students in subjects such as religious history or religious philosophy—provided, that is, that such courses contain themselves to the objective study of religion.[451] Simply put, there is a difference between teaching and preaching, and it is the line separating the two that public schools may not cross. As Justice Black so eloquently put it in *McCollum*:

> Music without sacred music, architecture minus the cathedral, or painting without the scriptural themes would be eccentric and incomplete, even from a secular point of view. Yet the inspirational appeal of religion in these guises is often stronger than a forthright sermon . . . . Certainly a course in English literature that omitted the Bible and other powerful uses of our mother tongue for religious ends would be pretty barren. And I should suppose it is a proper, if not an indispensable, part of preparation for worldly life to know the roles that religion and religions have played in the tragic story of mankind. The fact is that for good or for ill, nearly everything in our culture worth transmitting, everything which gives meaning to life, is saturated with religious influences . . . . One can hardly respect a system of education that would leave the student wholly ignorant of the currents of religious thought that move the world society for a part in which he is being prepared.[452]

---

449. Levy made the following comments regarding this problem: "The American Civil Liberties Union has not always understood. Suits brought by the ACLU to have courts hold unconstitutional every cooperative relationship between government and religion can damage the cause of separation by making it look overrigid and ridiculous." LEVY, *supra* note 9, at 240. For an example of overrigid absurdity, see John M. Hartenstein, *A Christmas Issue: Christian Holiday Celebration in the Public Elementary Schools is an Establishment of Religion*, 80 CALIF. L. REV. 981 (1992), in which the author posits that, among other things, creating Christmas art and decorations, singing Christmas carols, and decorating the classroom and exchanging gifts at Christmastime, violate the Establishment Clause. *Id.* at 1026.

450. *See, e.g.*, Lamb's Chapel v. Center Moriches Union Free Sch. Dist., 113 S. Ct. 2141, 2149 (Scalia, J., concurring).

451. *See* Justice Clark's majority opinion in *Abbington Township*, where he posits:

> [I]t might well be said that one's education is not complete without a study of comparative religion or the history of religion and its relationship to the advancement of civilization. It certainly may be said that the Bible is worthy of study for its literary and historic qualities. Nothing we have said here indicates that such study of the Bible or of religion, when presented objectively as part of a secular program of education, may not be effected consistently with the First Amendment.

Abbington Township, 374 U.S. at 225.

452. McCollum v. Board of Education, 333 U.S. 203, 236 (1948).

Yet one has to wonder how many students at any level of public education have a basic understanding of the tenets and the history of the major religions. So long as comparative religious studies are ignored, then students in public schools will not only be indoctrinated with distorted history but also possess a fundamental lack of understanding regarding the advancement of civilization.[453] Moreover, failure to emphasize secular courses in comparative religion and religious history may aid in the production of generations of children who possess no moral code.[454] While it is certainly not a function of public education to indoctrinate children with religion, it is the sad realism that if public schools do not attempt to provide pupils with moral guidance and some semblance of a framework for resolving moral dilemmas and making moral choices, then many students will never receive such instruction. Although the study of morality may be attempted and perhaps accomplished without a discussion of how various religions approach moral problems, it is indisputably not complete without such discourse.[455] It is this function which the objective study of religion best serves.[456]

---

453. For a similar conclusion, see Warren A. Nord, *Religion, the First Amendment, and Public Education*, 8 B.Y.U. J. PUB. L. 439 (1994), where the author states:

> There are, however, good secular, liberal reasons for requiring the study of religion in the public schools.
>
> A liberal education must avoid indoctrination. We indoctrinate when we systematically avoid giving students the intellectual and imaginative resources to make sense of competing interpretations of contested matters. . . . [A] good deal of what we teach students—about history, nature, morality, and human nature—is religiously contested, yet students are taught virtually nothing about religious interpretations of these contested matters. In this respect, public education is strikingly illiberal; public education indoctrinates students against religion.

Id. at 439.

454. Consider in this regard, Justice Jackson's dissent in *Everson*. There, he stated that our public school system

> is organized on the premise that secular education can be isolated from all religious teaching so that the school can inculcate all needed temporal knowledge and also maintain a strict and lofty neutrality as to religion. The assumption is that after the individual has been instructed in worldly wisdom he will be better fitted to choose his religion.

Everson, 330 U.S. at 23-24. Jackson's assumptions are unrealistic. Religious views, as are most others, are usually developed during childhood and adolescence. It is highly unlikely that one who has no concept of either the function of religion or an understanding of the major world religions, will, upon completion of secular studies, be better fitted to choose his religion.

455. Unfortunately, this is the alternative currently in favor. One author explains the inconsistencies between this view's supporters and their justification—liberal neutrality—for supporting this view, as follows:

> This is the phenomenon of selective multi-culturalism: boundless tolerance and respect for some voices, and ruthless suppression of others.
>
> . . . .
>
> The effect of selective post-modernism is to allow secular ideologies to use political muscle to advance their causes, including using the public schools to inculcate their ideals, without even the psychological constraint of liberal neutrality, but at the same time to preserve liberal formalism in court to ensure that religion is not included in the public dialogue. Thus, in New York City the children are read Heather Has Two Mommies in the first grade and given information on anal intercourse in the sixth; but, as the Tenth Circuit recently held, The Bible in Pictures must be removed from the shelf of the first grade classroom library.

Michael W. McConnell, *"God Is Dead and We Have Killed Him!": Freedom of Religion in the Post-Modern Age*, 1993 B.Y.U. L. REV. 163, 187-88.

456. Note that such a study would not be complete without discussing the option of irreligion,

Fear of Establishment Clause litigation has also chilled the willingness of legislatures and school districts to authorize moments of silence, which, contrary to popular belief, the Court has not deemed unconstitutional. In fact, the very Court that declared unconstitutional the Alabama statute in *Wallace v. Jaffree* remarked that "[t]he legislative intent to return prayer to the public schools, is of course, quite different from merely protecting every student's right to engage in voluntary prayer during an appropriate moment of silence during the schoolday."[457] In that same case, Justice Powell agreed fully with Justice O'Connor's assertion, which stated:

> Nothing in the United States Constitution as interpreted by this Court or in the laws of the State of Alabama prohibits public school students from voluntarily praying at any time before, during or after the schoolday. Alabama has facilitated voluntary silent prayers of students who are so inclined by enacting [a law] which provides a moment of silence in appellees' schools each day. *The parties to these proceedings concede the validity of this enactment.*[458]

Hence, states are free to authorize moments of silence provided they do not, explicitly in the statute or its history, or as applied through teachers, encourage students to use the moment for prayer. Because moment of silence statutes do not aid, even incidentally, religion or religious sects, or favor religion over irreligion, they should withstand Establishment Clause challenges. Similarly, because moments of silence possess no coercive element sufficient to trigger a Free Exercise Clause attack, they constitute a workable compromise between mandatory school prayer and perceived separationist hostility towards religion. Indeed, as Justice O'Connor noted in *Wallace*, "It is difficult to discern a serious threat to religious liberty from a room of silent, thoughtful schoolchildren."[459]

In short, the Supreme Court's attempt to micromanage the smallest influence of religion in the nation's public schools has proved disastrous. Instead of recognizing that cultural and religious practices vary by locale, it has imposed a single standard by which it measures every state practice touching religion. Rather than attempting to understand and compensate for these innumerable differences, however, the Court should return to local school districts and state legislatures control over its public school curriculum. If nothing else, *Kiryas Joel* stands as a reminder of what happens when the Court interferes in effective local solutions to solely local problems.[460] Concerning the Court's oversight of public schools, a perceptive Justice once posited, "However wise this Court may be or may become hereafter, it is doubtful that, sitting in Washington, it can successfully supervise and censor the curriculum of every public

---

or atheism, which like religion proffers an outlook on life and offers a method of moral problem solving.

457. Wallace v. Jaffree, 472 U.S. 38, 59 (1985).

458. *Id.* at 67 (O'Connor, J., concurring) (emphasis added).

459. *Id.* at 73. Chief Justice Burger, in dissent, remarked that he would add to O'Connor's statement, "even if they choose to pray." *Id.* at 90 (Burger, J., dissenting). He then quoted sarcastically from Horace, "The mountains have labored and brought forth a mouse." *Id.*

460. *See supra* notes 260-75 and accompanying text.

school in every hamlet and city in the United States. I doubt that our wisdom is so nearly infallible."[461]

C. *(Mis)Interpreting Framers' Intent*

The Supreme Court's entire Establishment Clause jurisprudence, including its ill-fated *Lemon* test, is grounded in its separationist interpretation of Framer's intent. Unfortunately, a person reading the Supreme Court's Establishment Clause opinions would presume first that Madison and Jefferson opposed any governmental support, be it state or national, of religion, and second, that no other Founder or Framer expressed any views on the matter. While correct to an extent, such unnecessarily broad statements are misleading. Although Madison and Jefferson were strong advocates of separation of church and state, neither adhered to, or practiced while in public office, an overly rigid separation. In this respect, the Court, as well as many commentators, conveniently overlook the acts and writings of Madison and Jefferson which either conflict with separationism or reflect a nonpreferentialist tendency. Moreover, those who overemphasize Madison's *Remonstrance* and Jefferson's Danbury letter and Virginia Bill for Religious Freedom inadvertently simplify Madison's and Jefferson's church-state jurisprudence.

1. Madison

Consider in this respect that the *Remonstrance* is only one of many documents of a religious nature penned by Madison. In fact, only four years after writing the *Remonstrance*, Madison drafted the Bill of Rights, including, of course, the Establishment Clause. His first draft, which was not adopted, read as follows: "The civil rights of none shall be abridged on account of religious belief or worship, nor shall any national religion be established, nor shall the full and equal rights of conscience be in any manner, or on any pretext, infringed."[462] Although critics rightly dismiss this initial version as insignificant in determining the collective intent of the Framers, it serves one crucial purpose: as the sole product of Madison, it is demonstrative of his, and only his, intent at the time he introduced it.[463] Because Madison was unsure whether the House would adopt his proposed amendment wholesale, the assertion that it fails to reflect his intent is illogical.[464] Clearly, Madison's first proposal manifested a fundamental concern with prohibiting the national government from establishing a national religion.[465]

---

461. Epperson v. Arkansas, 393 U.S. 97, 114 (1968) (Black, J., concurring).

462. ADAMS & EMMERICH, *supra* note 19, at 17.

463. *See* CORD, *supra* note 8, at 26.

464. *Id.*

465. Levy states that nonpreferentialist assertions that Madison meant only a national church when adopting the amendment are groundless. LEVY, *supra* note 9, at 123. Levy's claim belies the available legislative history. While Madison may certainly have intended more, the scant history and all the debate indicate that Madison, and the other Framers for that matter, were concerned with national establishments. As will be shown, however, this does not mean Madison's views can be characterized as nonpreferential.

Other acts and documents further demonstrate that Madison developed not a simple separationist viewpoint, but a complex church-state jurisprudence, which was in some instances separationist, in other instances nonpreferentialist. For example, not only did Madison oppose including ministers in the census,[466] but he also objected vehemently, as a member of the Continental Congress in 1785, to an attempt by that Congress to reserve, in the Northwest Ordinance, public land for religious use throughout townships in the western territories.[467] Despite these undoubtedly separationist acts, Madison later served on the Congress committee that authorized congressional chaplains.[468] Moreover, as a member of that same Congress, Madison never objected to a proclamation for a day of thanksgiving to allow "the people of the United States a day of public thanksgiving and prayer, to be observed by acknowledging, with grateful hearts, the many signal favors of Almighty God, especially by affording them an opportunity to peaceably establish a Constitution of government for their safety and happiness."[469]

Madison's actions as the fourth President further cloud the issue. While in office, he issued three proclamations for days of fasting and one for a day of thanksgiving.[470] Although these proclamations were undoubtedly of a religious nature, Madison nonetheless vetoed two different bills concerning religious matters. The first involved a congressional attempt to reserve federal land for a Baptist church which, because of a surveying error, had constructed its building upon federal land.[471] Congress's solution summarily granted the land to the church.[472] Madison, however, objected to the transaction and vetoed the bill because it "comprise[d] a principle and precedent for the appropriation of funds of the United States for the use of and support of religious societies, contrary to the article of the Constitution which declares that 'Congress shall make no law respecting a religious establishment.'"[473] The second bill Madison vetoed an attempt by Congress to incorporate an Episcopal church in the District of Columbia.[474] Despite these vetoes, Madison approved chaplains for the armed forces,[475] an action entirely inconsistent with

---

466. *Id.* at 130. To this end, he stated that with regard to those
> employed in teaching and inculcating the duties of religion, there may be some indelicacy in singling them out, as the general government is proscribed from interfering, in any manner whatsoever, in matters respecting religion; and it may be thought to do this, in ascertaining who, and who are not ministers of the gospel.

Id.

467. *Id.* at 129. Madison voiced this opposition in a letter in which he stated, "How a regulation, so unjust in itself, so foreign to the Authority of Congress . . . and smelling so strongly of an antiquated Bigotry, could have received the countenance of a Committee is truly a matter of astonishment." *Id.* at 129-30. Notwithstanding Madison's admonitions, the Northwest Ordinance included a provision reading, "Religion, morality, and knowledge, being necessary to good government and the happiness of mankind, schools and the means of education shall forever be encouraged." CORD, *supra* note 8, at 61.

468. CORD, *supra* note 8, at 25.

469. *Id.* at 28.

470. ADAMS & EMMERICH, *supra* note 19, at 25.

471. LEVY, *supra* note 9, at 119.

472. *Id.*

473. *Id.*

474. ADAMS & EMMERICH, *supra* note 19, at 25.

475. LEVY, *supra* note 9, at 121.

the views expressed in his Baptist church land grant veto that no appropriation of government funds could be used to support religion.

Taken together, it is at the least difficult, if not impossible, to assimilate this mass of writings and acts and produce a definitive, comprehensive statement of Madison's intent with respect to church and state. Fortunately, one of Madison's own writings, entitled the "Detached Memoranda,"[476] clarifies much of the confusion. Although Madison wrote the Detached Memoranda after the end of his political career in 1817, it remained undiscovered until 1946, when it was found in the family papers of William C. Rives.[477] In the Memoranda, Madison took a very broad view of the Establishment Clause, contending that thanksgiving day proclamations, other religious proclamations, and congressional chaplains all violate the Constitution. He articulated this as follows:

> Is the appointment of Chaplains to the two houses of Congress consistent with the Constitution, and with the pure principle of religious freedom?
>
> In strictness the answer on both points must be in the negative. The Constitution of the U.S. forbids anything like an establishment of a national religion. The law appointing Chaplains establishes a religious worship for the national representatives, to be performed by Ministers of religion, elected by a majority of them; and these are to be paid out of the national taxes. Does not this involve the principle of a national establishment, applicable to a provision for a religious worship for the Constituent as well as of the representative Body, approved by the majority, and conducted by Ministers of religion paid out by the entire nation.
>
> The establishment of the chaplainship to Congress is a palpable violation of equal rights, as well as of Constitutional principles . . . .[478]

This portion of the Memoranda denotes two important points. First, Madison believed the Constitution forbad more than just establishments of religion. As stated above, he construed the Constitution to prohibit "anything like an establishment of religion." Second, despite his presidential proclamations and his membership on the committee that approved the congressional chaplains, he considered them unconstitutional. It is unclear, however, whether he considered the above issues and actions unconstitutional at the time he made the proclamations and appointments, or whether these views developed over the course of three decades and were ultimately embodied in the Memoranda. The evidence dictates that it must be the latter. It is unlikely that the same Madison who spoke out vehemently against legislative proposals regarding religion would meekly submit without objection to the proposal of chaplains had he

476. James Madison, untitled manuscript, *reprinted in* Elizabeth Fleet, *Madison's 'Detached Memoranda'*, 3 WM. & MARY Q. 534, 535-68 (1946).

477. CORD, *supra* note 8, at 29. The document was purportedly in Madison's handwriting and authentic. *Id.*

478. Madison, *supra* note 476, at 558.

thought them unconstitutional.[479] The same can be said of the Madison who issued thanksgiving day and other religious proclamations while President, but who in the Memoranda asserted that presidential proclamations of this nature were unconstitutional.[480] It stretches reason to assume that Madison, the most outspoken figurehead of the separationists for thirty years, did so, as he claimed in a letter in 1822, for political expediency.[481] Rather, it is more likely he considered the proclamations constitutional at the time he made them, but later changed his mind.

Although this is a subtle distinction, its meaning is crucial. If Madison believed the acts constitutional when drafting the Constitution and the Bill of Rights and while serving as President, then as Cord states, "Madison should be judged on his behavior, statements, and actions while he was a public servant in the House and in the Presidency, making policy and accountable for it."[482] To the extent one attempts to discern the intent of Madison as a Framer this is correct. Note that even if Madison, as a public servant, considered the proclamations and appointments unconstitutional, no evidence exists to suggest the majority of the remaining Framers shared this view and enshrined it in the First Amendment. Certainly when one considers Madison's intent on a singular rather than a collective level, the Detached Memoranda makes unmistakably clear that Madison, after contemplating the matter for many years, concluded that religious proclamations, congressional chaplains, and any other legislation[483] concerning religion *should be* unconstitutional. In other words, if Madison believed that proclamations and chaplains were constitutional when he approved them, then when using Madison as a barometer of original Framers' intent, commentators should not rely on his later, more stringent views such as those expressed in the Detached Memoranda. This is so because, as the debates evidenced, Madison was deeply involved in articulating to the other Framers what he believed the Clauses to mean. It is not a fair historical determination of intent to attribute to the other Framers views developed by Madison *after* the framing. Those views are relevant only to the extent that they are used to ascertain Madison's intent apart from the other Framers, i.e., his individual church-state jurisprudence which only developed into the strict views expressed in the Memoranda nearly thirty years after the Constitution and Bill of Rights were framed.

2. Jefferson

Unlike Madison, whose works other than the *Remonstrance* have been simply ignored, the works of Jefferson have been unabashedly misinterpreted, and none more so than the fabled Virginia Bill for Religious Freedom.[484] Al-

479. *See* CORD, *supra* note 8, at 32-33.
480. LEVY, *supra* note 9, at 123.
481. CORD, *supra* note 8, at 31.
482. *Id.* at 36.
483. In the Detached Memoranda, Madison also indicated, by way of an example in Kentucky, his opposition to attempts to exempt churches from taxes. Madison, *supra* note 476, at 555.
484. This is not to suggest that courts and scholars have not ignored those acts and writings of Jefferson which are inconsistent with the view adopted by that court or scholar, but rather that

though the Supreme Court has alluded to this Bill on many occasions for support of Jefferson's intent, it has severed the Bill from its historical context and manipulated its intention and effect. Consider, for example, the Court's sweeping assumption in *Everson* that the ideas expressed in the Virginia Bill were not merely consistent with, but embodied and were in fact the same as the provisions later enshrined in the First Amendment.[485] This assumption effectively renders irrelevant the experiences and intent not only of every Framer not involved in the Virginia struggle, but also of every state but Virginia. In fact, the Bill has no bearing whatsoever on the intent of the Framers with respect to the Establishment Clause. It was passed by the Virginia legislature before the Establishment Clause even existed. Moreover, even had the Clause existed, the Bill would be virtually irrelevant. Because the Establishment Clause concerns only the national government, the state governments, including Virginia's, were free to deal with religion as they so chose. Hence, to this end the Bill's only interpretive use is as a barometer of Jefferson's—and to a great extent, Madison's—impressions of the appropriate church and state relationship.[486] Note that Jefferson's noninvolvement in the framing of the Constitution and the Bill of Rights further decreases the Virginia Bill's utility as a reflection of the Establishment Clause.[487]

Jefferson was more consistent, although not entirely consistent, than Madison with respect to his actions regarding religion while serving as a public official. For example, as President, Jefferson demonstrated a separationist bent when he broke with the proclamation tradition instituted by Washington and Adams, and refused to issue pronouncements for days of thanksgiving and national prayer. CORD, *supra* note 8, at 40. He explained his reasons in a letter to a Presbyterian clergyman:

> I consider the government of the United States as interdicted by the Constitution from intermeddling with religious institutions, their doctrines, disciplines, or exercises. This results not only from the provision that no law shall be made respecting the establishment or free exercise of religion, but from that also which reserves to the States the powers not delegated to the United States. Certainly no power to prescribe any religious exercise, or to assume authority in religious discipline, has been delegated to the general government. It must then rest with the States, as far as it can be in any human authority.

Id. Although Jefferson's letter reveals his belief that presidential religious proclamations conflicted with the Religion Clauses, it also underscores his objections to the proclamations on *federalism* grounds. *Id.* Hence, even in the absence of the Religion Clauses, Jefferson would not have issued any religious proclamations.

Notwithstanding Jefferson's break with tradition, he signed into law three extensions of an act which purported to, among other things, "regulate the grants of land appropriated . . . for the society of the United Brethren for propagating the gospel among the heathen." *Id.* at 45. Jefferson further sought and received congressional approval of a treaty with the Kaskaskia Indians contingent upon the national government using federal funds to support a Catholic priest and assist the tribe in constructing a church. *Id.* at 38.

485. Everson v. Board of Education, 330 U.S. 1, 13 (1947).

486. Not all commentators agree. For example, Richard Morgan concludes that Madison's *Remonstrance* set the stage for the Virginia Bill which in turn led to development of a "secularist theory of religious freedom and separation of church and state which within a few short years came to underpin and inform the religion clauses of the new First Amendment." MORGAN, *supra* note 76, at 18. The deficiency in this view, however, is that not all the Framers of the First Amendment participated in drafting either Madison's *Remonstrance* or the Virginia Bill for Religious Liberty. Thus, Morgan's view belittles the views and intent of those nonparticipating Framers.

487. Chief Justice Rehnquist noted the irrationality of the Court's heavy reliance on Jefferson by stating, "He would seem to any detached observer as a less than ideal source of contemporary history as to the meaning of the Religion Clauses of the First Amendment." Wallace v. Jaffree, 472 U.S. 38, 92 (1985) (Rehnquist, J., dissenting).

Courts and commentators also have conveniently overlooked the historical context overlaying the Bill. Again, *Everson* serves as an example. There, Justice Rutledge opened his dissent by quoting the preamble to Jefferson's Virginia Bill and proceeded to state, "I cannot believe that the great author of those words, or the men who made them law, could have joined in this decision."[488] Rutledge was wrong. He either ignored or was not aware that Jefferson, Madison, and all the rest of the Virginia Bill supporters passed statutes much more entangled with religion than the one at issue in *Everson*. Indeed, passage of the Bill was part of a "comprehensive revision of Virginia's laws, which included: A Bill for Punishing Disturbers of Religious Worship and Sabbath Breakers; A Bill for Appointing Days of Public Fasting and Thanksgiving; and A Bill Annulling Marriages Prohibited by the Levitical Law, and Appointing the Mode of Solemnizing Lawful Marriage."[489] Clearly, these bills dabbled not only in religious subjects modern courts would unhesitatingly label unconstitutional, but also on subjects much more pervasively supportive of religion than simply busing children to and from religious schools. Yet the very legislature that passed the Bill for Religious Freedom passed these bills as well.[490]

Finally, consider the religious nature of the Bill, which instead of being neutral as regards religion, presumed a belief in God.[491] Because of modern separationist dogma with respect to any law which espouses a religious preference, those courts which have historically touted the Bill's grandeur would be required to strike it down should a state enact it today.[492] The absurdity of this belies both common sense and the Constitution.

Modern courts, in their quest for separationist support, have interposed their misunderstanding of history upon the Virginia Bill. Undoubtedly,

---

488. *Everson*, 330 U.S. at 29 (Rutledge, J., dissenting).

489. ADAMS & EMMERICH, *supra* note 19, at 23-24.

490. Note that the separationists are not alone in their misinterpretation of history. Consider, for example, the opinion of Justice Thomas in *Rosenberger*, where his historical assessment, although more accurate than Souter's, was not flawless. Admittedly, he understood the underlying nature and limitations of both the *Remonstrance* and the Virginia Bill. For example, he correctly noted that Madison objected not to religious participation in neutral government programs but to a specific tax imposed solely for the benefit of Christian teachers. Rosenberger v. Rector & Visitors of the Univ. of Va., 115 S. Ct. 2510, 2529 (1995) (Thomas, J., concurring). Nonetheless, Thomas proceeded to adopt a nonpreferentialist view, and unfortunately based this conclusion in part on Madison's *Remonstrance*. *Id.* at 2529-30. Although Thomas correctly assumed Madison sought to prevent the national government from establishing a national church, he failed to mention Madison's Detached Memoranda, which clearly foreclosed any nonpreferentialist assumptions regarding Madison's church and state jurisprudence. Indeed, it is these uninformed oversights that reduce the credibility of Thomas's opinion. Consider also Thomas's discussion of the historical support for excluding churches from property taxes. *Id.* at 2531. In this section, Madison's name is nowhere to be found, yet in the Detached Memoranda he explicitly indicated his opposition to such exemptions. Perhaps sensing the incompatibility of Madison's views with his own, Thomas rightly remarked that "the views of one man do not establish the original understanding of the First Amendment." *Id.* at 2530. In short, Thomas should have ended his historical appraisal upon correctly concluding that "there is no indication that at the time of the framing [Madison] took the dissent's view that the government must discriminate against religious adherents by excluding them from more generally available government financial subsidies." *Id.*

491. Dreisbach, *supra* note 56, at 187.

492. *See id.* at 188 (citing American Jewish Congress v. City of Chicago, 827 F.2d 120, 136 (7th Cir. 1987) (Easterbrook, J. dissenting)).

Jefferson supported separation of church and the national government. His refusal to issue thanksgiving and other religious day proclamations is but one example of this conclusion. Nonetheless, Jefferson, as did Madison and every other Framer, professed and practiced the belief that the states were free to legislate with respect to religion.[493] There were no limits on state power to do so. The various Virginia bills pertaining to religion exemplify this federalism-based precept. Furthermore, the notion that Jefferson favored a separation of church and state is true only when considered in its historical context of state freedoms.[494] But Jefferson, and Madison for that matter, did not live in a United States where the Supreme Court turned the Constitution inside out; moreover, neither lived in the era of incorporation and federally imposed state restraints. Surely, had they lived in such times, they would be most distressed to see their tools, which were designed to ensure religious liberty, used so spuriously and deceptively to destroy it.

3. The Lost Founders

An unfortunate byproduct of the understandable tendency of jurists and commentators to emphasize the views of Madison and Jefferson is the corresponding failure to consider the view of the other Framers and Founders. Indeed, noticeably absent from most discussions of church and state are the views of some of the nation's earliest and most esteemed leaders, such as George Washington, John Adams, John Marshall, and others.[495] Many of these individuals were "political centrists," who not only "looked favorably on organized religion as necessary for social cohesion," but also "believed that religion was an essential cornerstone for morality, civic virtue, and democratic government."[496]

---

493. *See* Poppel, *supra* note 416, at 250 ("In the search for the original intent of the Framers concerning the Religion Clauses, one fact is taken as irrefutable by virtually all commentators: at the time of the ratification of the Constitution, it was not the intention of the Framers to apply the Religion Clauses to the States.").

494. One commentator has articulated this precept as follows:

> Where the Court has gone astray in its Religion Clause jurisprudence is in using the original intent of the Framers to justify a Religion Clause jurisprudence with respect to First Amendment limitations on state action. The only clear "original intent" of the Framers is that the Religion Clauses were not to apply to the states. Once the Court decided to incorporate the Religion Clauses against the states, it nullified the importance of "original intent" in this area, at least with respect to defining the limitations imposed on the states. The grand searches for original intent seen in *Everson*, *Wallace*, and other opinions are futile once it is understood that, while the Framers of the First Amendment might have had an intention regarding the application of the Religion Clauses to the national government, they had no such intention regarding application of the clauses to the states except that they were not intended to apply to the states.

Id. at 267-68.

495. Levy stated that Madison's view, which Levy claims to be strict separation, "was widely shared by the other framers of the Constitution." LEVY, *supra* note 9, at 119. This conflicts with Adams's and Emmerich's position that the Founders (including the Framers) shared a wide variety of views; Madison's and Jefferson's did not predominate. ADAMS & EMMERICH, *supra* note 19, at 26. For a discussion of the personalities of the Framers, see Frederick M. Gedicks, *The Rise and Fall of the Religion Clauses*, 6 B.Y.U. J. PUB. L. 499 (1992).

496. ADAMS & EMMERICH, *supra* note 19, at 26. Consider in this vein Benjamin Franklin, who, although better known for other endeavors, played an important role in the early formation of the United States, and deserves mention here. Franklin, a Framer at the Constitutional Conven-

Washington exemplified this description. As President he proclaimed a national day of thanksgiving for the people to acknowledge "that great and glorious Being for the civil and religious liberty with which we are blessed."[497] The following reply to the Jewish Congregation of Newport further indicates both his great respect for religion and his enthusiasm for religious freedom: "It is now no more that toleration is spoken of, as if it was by the indulgence of one class of people, that another enjoyed the exercise of their inherent natural rights."[498] While in office, Washington also effected a treaty in which the United States paid one thousand dollars to build a church.[499] This action, more than any other of Washington's Presidential tenure, is inapposite separationism. If as separationists contend, any governmental regulation respecting religion is prohibited, then Congress violated the First Amendment three years after it became effective.[500] Moreover, while Washington was an unavowed advocate of religious freedom and toleration, his actions, particularly his proclamations, indicate he did not believe the Constitution precluded all federal government action with respect to religion. To this end, consider the following remarks delivered at his farewell address:

> [L]et us with caution indulge the supposition that morality can be maintained without religion. Whatever may be conceded to the influence of refined education on minds of peculiar structure, reason and experience both forbid us to expect that national morality can prevail in exclusion of religious principle.[501]

Hence, while Washington certainly was not supportive of a national church or establishment or preferential treatment for any one sect, he likely believed that national encouragement of religious practice both was necessary and permitted to preserve social order and maintain the moral good.[502]

Other prominent figures shared Washington's convictions. John Adams, for example, not only continued Washington's practice of declaring days of

---

tion in 1787, was bothered by the slow progress of the group. He stated:

> I have lived, Sir, a long time, and the longer I live, the more convincing proofs I see of this truth—that God Governs in the affairs of men. And if a sparrow cannot fall to the ground without his notice, is it probable that an empire cannot rise without his aid? We have been assured, Sir, in the sacred writings, that "except the Lord build the House they labor in vain that build it." I firmly believe this . . . .
>
> I therefore beg leave to move—that henceforth prayers imploring the assistance of Heaven, and its blessings on our deliberations, be held in this Assembly every morning before we proceed to business, and that one or more of the Clergy of this City be requested to officiate in that Service.

CORD, *supra* note 8, at 24-25. Although the motion was seconded, no vote was ever taken on it because of fear expressed by others that although such a motion might have been proper at the beginning of the Convention, if it was not adopted, the public might perceive that the Convention's troubles were so great as to resort only to divine assistance. *See id.* at 25.

497. CORD, *supra* note 8, at 26.

498. *Id.* at 27.

499. *Id.* at 58.

500. *Id.*

501. George Washington, Farewell Address, 1796, *in* ADAMS & EMMERICH, *supra* note 19, at 21.

502. *See, e.g., id.* ("He believed that 'Religion and Morality are the essential pillars of Civil society' and affirmed that everyone should be 'protected in worshipping the Deity according to the dictates of their consciences.'").

Thanksgiving, but declared two national fast days to allow for the "promotion of that morality and piety without which social happiness can not exist nor the blessings of a free government be enjoyed."[503] Chief Justice John Marshall admitted that "[l]egislation on the subject [religion] is admitted to require great delicacy, because freedom of conscience and respect for our religion both claim our most serious regard."[504] By using the term legislation, Marshall implicitly rejected a broad construction of the Establishment Clause because separationism by definition precludes legislation.

Consider also Justice Joseph Story, Associate Justice of the Supreme Court from 1811 to 1845, who in his treatise on the Constitution said the following with regard to religion:

> The real difficulty lies in ascertaining the limits to which government may rightfully go in fostering and encouraging religion. The real object of the First Amendment was . . . to exclude all rivalry among Christian sects, and to prevent any national ecclesiastical establishment which should give to a hierarchy the exclusive patronage of the national government.[505]

These statements presuppose that the Constitution permits the federal government, within prescribed limits, to use legislation to foster or encourage religion.[506]

To be sure, one cannot categorically characterize the Framers or Founders collectively as strict-separationist or nonpreferentialist. It is instead both more accurate and more reasonable to depict, as the evidence suggests, that the Framers' views on church and state fell along a continuum which spans these two extremes.[507] The Supreme Court has, unfortunately, relied exclusively on the separationist writings of James Madison and Thomas Jefferson when considering Establishment Clause disputes. The Court has reduced the Establishment Clause to nothing more than the collective intent of those two figures. In any event, the Court's long held view, first proffered in *Everson*, that the Framers' intent was indisputably separationist is historically baseless and inaccurate.

D. *Federalism and the Problem with Incorporation*

As evidenced by the preceding case discussion, virtually every Establishment Clause case involves disputes between individuals and state or local

---

503. *Id.* at 27.

504. *Id.* at 28. Marshall further stated: "The American population is entirely Christian and with us, Christianity and Religion are identified. It would be strange indeed, if with such a people, our institutions did not presuppose Christianity, and did not often refer to it, and exhibit relations with it." *Id.* Although few would argue that the modern United States is as religiously homogeneous as when Marshall made his statement, his characterization demonstrates that not all Framers thought the Constitution prohibited the national government from interacting with religion and religious institutions.

505. CORD, *supra* note 8, at 13.

506. For an argument that Story's views never led anywhere and were in effect meaningless, see MORGAN, *supra* note 76, at 40.

507. *See* ADAMS & EMMERICH, *supra* note 19, at 22.

governmental bodies. Only a scant few involve actions by the national government. Moreover, the entire jurisprudential area is relatively young, dating back only to 1947 and the *Everson* decision. In fact, *Everson* was the first substantive Establishment Clause case heard by the Supreme Court, despite the fact that the Clause had been in place for over 150 years. During this period, it was the state governments, rather than the federal government, which exercised control over religious legislation. It was only when the Establishment Clause was incorporated in *Everson* that the Clause's mandates became binding upon the states via the Fourteenth Amendment's Due Process Clause. The Court's decision to fully incorporate the Establishment Clause has proved to be a poor one.[508] Mountains of litigation have resulted, and problems which were previously resolved on a state and local level are now being decided by various branches of the federal government which are insensitive to local preferences, cultures, and problems.[509] More fundamental difficulties which plague the Establishment Clause's incorporation are its lack of historical support and its rebuke of the federalism upon which its passage was based.

In short, any understanding of the Establishment Clause must be based on an understanding of federalism. Federalism essentially mandates that the federal government is one of enumerated powers, and that it may not, theoretically, and consistent with the Constitution, take any actions not specifically and explicitly authorized by the Constitution's text.[510] This incontrovertible view of federalism with respect to the Establishment Clause persisted for over 150 years, during which time the Supreme Court twice condoned it: first in *Barron v. Baltimore*,[511] later in *Permoli v. New Orleans*.[512] Those in favor of

---

508. Others agree. For example:

> [C]onfusing case law has led the Justices themselves to describe their Establishment Clause doctrine as a muddle that lacks clear principles and departs from the intent of the Framers. Some commentators have argued that this doctrinal confusion was the inevitable consequence of the Court's decision to incorporate the Establishment Clause against the states in spite of the intent of the Framers of the First Amendment.

Note, *supra* note 78, at 1702.

509. One commentator states that

> perhaps the most important value to be served by restoring state authority over religion would be the federalist value of decentralized decisionmaking. This method of political organization confers two principal benefits. First, states and localities can better respond to the needs and interests of the majority of their citizens than the national government because they can tailor their laws to suit local conditions and preferences.

Id. at 1715.

510. Given these restricted federal powers, Madison and many other Framers felt a bill of rights unnecessary. LEVY, *supra* note 9, at 125. Because the Constitution did not grant Congress any power to legislate with respect to religion, speech, etc., the populace, at least theoretically, had no reason to fear federal usurpation of state power. Rather, Madison believed that neither the Constitution nor explicit guarantees would assure religious liberty. Instead, he declared that it was a multiplicity of sects, i.e., religious pluralism, that protected and secured religious liberty. *Id.* With numerous sects, one sect would be less likely to accumulate sufficient power to oppress the others. *Id.*

511. 32 U.S. (7 Pet.) 243 (1833).

512. 44 U.S. (1 How.) 589 (1845). In addressing the New Orleans ordinance in *Permoli*, the Court stated, "There is no repugnancy to the constitution, because no provision thereof forbids the enactment of law or ordinance, under state authority, in reference to religion. The limitation of power in the first amendment of the Constitution is upon Congress, and not the states." *Permoli*, 44 U.S. (1 How.) at 606.

extending the Establishment Clause's provisions to the states, however, found their fortune in the Fourteenth Amendment, which prohibits states from depriving any person of life, liberty, or property without due process of law. With respect to the Establishment Clause, the critical issue thus became whether state legislation respecting an establishment of religion constituted a deprivation of liberty.[513]

There can be no doubt that the Framers of the Fourteenth Amendment did not intend its liberty component to embody the Establishment Clause restraints.[514] The proposed Blaine Amendment confirms this. In 1875, just seven years after the ratification of the Fourteenth Amendment, Representative James G. Blaine sought approval of an amendment stating that, "No state shall make any law respecting an establishment of religion, or prohibiting the free exercise thereof."[515] This language, of course, correlates exactly with that in the Religion Clauses, which constrain only Congress. Although the amendment passed, it lacked the necessary two-thirds majority for submission to the states.[516] Its mere introduction, however, to a Congress which included twenty three members of the Congress which drafted the Fourteenth Amendment, illustrates undeniably that those who framed of the Fourteenth Amendment did not intend it to apply the Establishment Clause to the states. In short, had the Congress believed the Fourteenth Amendment encompassed the Establishment Clause, there would have been no need to affix to the Constitution a redundant amendment encompassing the Religion Clauses.

As it turned out, however, the Supreme Court ignored this intent, and in 1947 held in *Everson* that the Establishment Clause applied to the states via the Fourteenth Amendment.[517] The incorporation process began, however, at least seven years before in *Cantwell v. Connecticut*.[518] There, the Court said:

> The fundamental concept of liberty embodied in [the Fourteenth] Amendment embraces the liberties guaranteed by the First Amendment. The First Amendment declares that Congress shall make no law respecting an establishment of religion or prohibiting the free exercise thereof. The Fourteenth Amendment has rendered the states as incompetent as Congress to enact such laws.[519]

With these words, the Court cast the die that led to the Establishment Clause's incorporation seven years later.

In the abstract, few would argue that the mandates of the First Amendment should not apply to the states as well as Congress. Indeed, free speech and free exercise of religion are two notions undoubtedly fundamental to the concept of ordered liberty. Yet some sense an inherent distinction between free

---

513. *See* LEVY, *supra* note 9, at 148.

514. Indeed, the evidence suggests that the Fourteenth Amendment was not designed to incorporate any provisions embodied in the Bill of Rights. *See* Alfred W. Meyer, *The Blaine Amendment and the Bill of Rights*, 64 HARV. L. REV. 939, 945 (1951).

515. *Id.* at 941.

516. *Id.* at 944.

517. Everson v. Board of Education, 330 U.S. 1 (1947).

518. 310 U.S. 296 (1940).

519. *Cantwell*, 310 U.S. at 303.

speech and free exercise and the establishment of religion.[520] These scholars assert that the Establishment Clause, unlike the other First Amendment clauses, does not protect individual freedoms or grant a right to engage in some specific action.[521] In short, because establishment of religion need not necessarily restrict an individual's free exercise rights, ordered liberty can exist in the absence of Establishment Clause incorporation.[522] As one commentator notes, however, Madison, Jefferson, and several preeminent religious founders believed prevention of establishment essential to freedom.[523] To the extent that this encompasses only formal establishments, I agree. But incorporating the Establishment Clause and interpreting it to prohibit states from nonpreferentially fostering and encouraging religion is inapposite to the First Amendment, which by its terms reserved religion for the states. Indeed, permitting states to make informed public policy decisions as to whether to encourage religion through nonpreferential means in no way detracts from any plausible notion of liberty.[524]

The federalist nature of the First Amendment theoretically renders the national government incapable of legislating, even nonpreferentially, with respect to religion. Yet that same Amendment theoretically preserves for the states legislative dominion over religion. Hence, the Court has disrupted the delicate balance of power intended by the Framers. The result is that the Court has proscribed every governmental body—local, state, and national—from enacting nonpreferential legislation on religious topics.[525]

As a feasible compromise, incorporation of the Establishment Clause should apply to the states only to the extent that it prohibits them from creating formal establishments and enacting religious legislation which exalts one religion or religious sects over others. The sensitive choice as to whether it

---

520. One commentator noted:

> The Framers intended the Establishment Clause to embody a principle of federalism. That is, the original purpose of the Clause was to prevent Congress from interfering with the variety of church-state relationships that existed in 1791. For this reason, the Establishment Clause was a uniquely poor candidate for incorporation against the states.

Note, *supra* note 78, at 1700.

521. *See* LEVY, *supra* note 9, at 228.

522. *Id.*

523. *Id.*

524. Indeed, states should today possess this right to *protect* religions. Unlike 200 years ago, as one author notes, "The great problem today is not the threat that religion poses to public life, but the threat that the state, presuming to embody public life, poses to religion." Richard J. Neuhaus, *A New Order of Religious Freedom*, 60 GEO. WASH. L. REV. 620, 632 (1992).

525. Others share this view. Consider the remarks of one commentator:

> In particular, since the incorporation of those clauses, the Court has infused its decisions with considerations of original intent and history that have the effect of misinterpreting the meaning of the Religion Clauses as they are applied to the states. The result . . . has been the alteration of the basic structure of those clauses; what began as a limitation of federal power designed to promote government regulation of religion at the state level, if there was to be any regulation of religion at all, has been turned upside down so that today the dominant force shaping church-state relations are the federal courts in general and the Supreme Court in particular. [T]he Court has failed to heed the belief of the founders that civil authority in religious matters, to the extent it could be exercised, was a state function.

Poppel, *supra* note 416, at 249.

wishes to expend valuable resources to foster, aid, or encourage[526] religion should rest with a state and its citizens.[527] Unlike the Supreme Court's approach, which was to fully incorporate and apply to the states the Establishment Clause and then spend two decades creating a historically unsupported and undoubtedly unworkable standard, this modified incorporation framework is consistent with both history and the Framers' intent. Indeed, as one commentator notes:

> [T]he only consensus among the Framers of the First Amendment about the appropriate relationship between church and state was to allow the states to decide the issue themselves. Thus, the only theory of the Establishment Clause that accurately captures the collective intent of the Framers and reflects their divergent views is federalism.[528]

VII. CONCLUSION

Modern Supreme Court Establishment Clause jurisprudence is based on both misinterpreted history and unfounded historical assumptions. Indeed, despite the wishes of Scalia or Souter, the Framers cannot be classified as either nonpreferentialist or strict-separationist. Rather, the history of the Establishment Clause demonstrates that no one philosophy emerged which clearly represented the entire group's beliefs. Moreover, the Supreme Court's incorporation of the Establishment Clause rendered the use of Framers' intent to

---

526. Encouragement of religion does not consist of prayer in schools or Bible reading in schools, but rather tax exemptions for parents who send their children to private religious schools, use of public school buses for sectarian school students to go on secular field trips, and teaching various religious (and nonreligious) approaches to morality in the public school system.

527. To this end, I do not advocate overturning the incorporation doctrine in its entirety, rather just a shift in its jurisprudential focus which reflects more Court respect for state rights and local decisions. Few are so naive as to faithfully, and foolishly, propose that the Court abolish the incorporation doctrine. However, the Court "might reinterpret precedents, distinguishing away some, blunting others, and making new law without the appearance of overruling or disrespecting the past." LEVY, *supra* note 9, at 232.

528. Note, *supra* note 78, at 1705. One commentator offers a compelling point in this respect: it is almost inconceivable that the Supreme Court will abandon the incorporation doctrine, and highly unlikely that it would ever modify the incorporation doctrine sufficiently to solve the problems currently facing it. As such, modern scholars are essentially avoiding the issue, which can be stated as follows:

> [E]ven scholars who have criticized the incorporation of the establishment clause have typically assumed that the clause continues to restrict the national government, as it was originally intended to do. But even that assumption seems unwarranted. If the religion clauses were an allocation of jurisdiction over religion to the states, and if that allocation has to be undone, then there is no justification—no *originalist* justification grounded in the First Amendment's religion clauses, at least—for holding even the national government to restrictions grounded in a jurisdictional arrangement that has long since been repudiated.
>
> More generally, the effort to develop an authoritative constitutional law of religious freedom based on the religion clauses of the First Amendment is in a sense similar to an effort to discuss the states' current constitutional authority to permit or regulate liquor on the basis of the Eighteenth Amendment, while ignoring the inconvenient fact that this amendment has been repealed. If there is to be constitutional law on either subject, it will have to be derived from some other source.

SMITH, *supra* note 40, at 50.

analyze state religious legislation inapposite to the Framers' understanding of the republic. It is like trying to put a round peg in a square hole—something just does not fit. That something is federalism. In short, it existed in 1789, but for all practical purposes exists in name only now. Recall that in the Framers' era, states were free to legislate with respect to religion; they could establish religions or restrict religious freedom—they were writing on a blank page. Incorporation, however, disrupted this balance of power. Hence, it is merely guesswork to suggest that Madison or Jefferson would have approved or disapproved of this or that bill. No one knows how any of the Framers would regard modern religion clause jurisprudence. For sure, most would not even recognize it as a product of the Constitution and Bill of Rights they created over 200 years ago. Likewise, most would also consider the federal government's encroachment into the sphere of state power, with respect to religion and innumerable other matters, palpable violations of their republican ideal.

Unfortunately, for nearly fifty years the Court has adhered to an unduly rigid separationist viewpoint. As a result, modern Courts must fight the temptation, and increasingly the popular demand, to shift too far the other way. The incorporation model proposed earlier grants states discretion as to whether or not to aid religion in evenhanded, neutral manners. Such an approach accounts both for the separationist fear of formal establishments and the nonpreferentialist appreciation for federalism. Finally, both sides would do well to recall the words of Chief Justice Rehnquist, who said, "The true meaning of the Establishment Clause can only be seen in its history."[529] In this respect, nonpreferentialists must recognize the importance of the Establishment Clause's underlying rationale—to secure the broadest possible level of religious freedom and protect the sanctity of the church. Similarly, separationists should heed the warning of John Adams, the nation's second President, who maintained, "Our Constitution was made only for a moral and religious people. It is wholly inadequate to the government of any other."[530]

John E. Joiner

529. Wallace v. Jaffree, 472 U.S. 38, 113 (1985) (Rehnquist, J., dissenting).
530. ADAMS & EMMERICH, *supra* note 19, at 27.

COMMENT

VERNONIA SCHOOL DISTRICT 47J V. ACTON: FLUSHING THE FOURTH AMENDMENT— STUDENT ATHLETES' PRIVACY INTERESTS GO DOWN THE DRAIN

> Our Government is the potent, the omnipresent teacher. For good or for ill, it teaches the whole people by its example. Crime is contagious. If the Government becomes a lawbreaker, it breeds contempt for law; it invites every man to become a law unto himself; it invites anarchy.[1]

INTRODUCTION

In the fall of 1991, the government became a lawbreaker. This occurred when a school district in Vernonia, Oregon imposed an unconstitutional mandate upon middle and high school students wishing to participate in their athletic programs. In order to compete, the students were required to submit to random drug testing of their urine.

In an effort to support the federal government's "War on Drugs," the Court sanctioned this illegal behavior when it failed to strike a balance between governmental power and individual rights. On June 26, 1995, the Court, in *Vernonia School District 47J v. Acton*,[2] held constitutional under the Fourth Amendment a district-wide policy authorizing random, suspicionless, urinalysis drug testing of students who participate in the District's public school athletic programs.[3] Despite the Court's efforts to follow what the Constitution prescribes, the Court did not adhere to precedent and instead created its own social agenda dictating how society should view the threat of drug use in our public schools.

This Comment analyzes the Court's decision regarding the constitutionality of the Vernonia School District's drug testing policy. Part I discusses the Fourth Amendment in both the criminal search and administrative search contexts. Additionally, Part I examines the various cases in which the Court developed a balancing test to resolve whether an administrative search is reasonable. Part II provides the factual background and procedural history of *Acton*. Part III scrutinizes the Court's reliance on *New Jersey v. T.L.O.*[4] as precedent for upholding the District's drug testing program. It specifically addresses how the majority's inaccurate application of *T.L.O.* undermines the Court's prior

---

1. Olmstead v. United States, 277 U.S. 438, 485 (1928) (Brandeis, J., dissenting).
2. 115 S. Ct. 2386 (1995).
3. *Acton*, 115 S. Ct. at 2397.
4. 469 U.S. 325 (1985).

decisions, which held that full, intrusive, suspicionless searches were reasonable if a compelling government interest beyond law enforcement was present. Finally, this Comment argues that the *Acton* opinion represents an unclear and unnecessary departure from Fourth Amendment standards. The decision effectively strips public school students of their legitimate expectations of privacy and security guaranteed by the Fourth Amendment.

I. BACKGROUND

A. *The Scope of the Fourth Amendment*

The Fourth Amendment to the United States Constitution "guarantees the privacy, dignity, and security of persons against certain arbitrary and invasive acts by officers of the Government or those acting at their discretion."[5] This language protects individuals from two types of governmental invasions: "searches" and "seizures."[6] A "search" occurs when a person's reasonable expectation of privacy is infringed upon.[7] A "seizure" of property occurs when there is some meaningful interference with an individual's possessory interest in that property.[8] In order to trigger Fourth Amendment protection against unreasonable governmental intrusions, an intrusion, as a threshold matter, must occur in an area where a citizen has a reasonable expectation of privacy.[9] A reasonable expectation of privacy exists if a person has an expectation of privacy that society is prepared to recognize as objectively reasonable.[10]

---

5. Skinner v. Railway Labor Executives' Ass'n, 489 U.S. 602, 613-14 (1989) (citing Camara v. Municipal Court, 387 U.S. 523, 528 (1967)). The Court has espoused an exclusionary remedy for violations of a defendant's constitutional rights. The first such decision was Weeks v. United States, 232 U.S. 383, 398 (1914) (holding that it was prejudicial error for a trial court to refuse to return letters and documents to the accused, and to allow their use in his trial, when obtained through a warrantless search conducted by a United States official under color of office). The exclusionary doctrine was later applied to the states in Mapp v. Ohio, 367 U.S. 643, 655 (1961) (holding that the exclusionary rule is enforceable against the states through the Fourteenth Amendment's Due Process Clause, due to the broad scope of the Fourth Amendment's right of privacy). This rule prohibits the use of evidence or testimony obtained by government officials through means violative of the Constitution. *Id.* at 648. Therefore, all evidence obtained by law enforcement officials through means lacking the constitutionally required degree of suspicion necessary to proceed are deemed invalid and inadmissible at trial if the defendant can establish that the evidence was obtained in an unconstitutional manner. Illinois v. Gates, 462 U.S. 213, 245 n.13 (1983) ("In making a determination of probable cause the relevant inquiry is not whether particular conduct is 'innocent' or 'guilty,' but the degree of suspicion that attaches to particular types of non-criminal acts."). Likewise, evidence subsequently derived from evidence erroneously obtained is inadmissible under the "fruit of the poisonous tree" doctrine. Wong Sun v. United States, 371 U.S. 471, 484, 488 (1963).

6. U.S. CONST. amend. IV.

7. *Railway Labor Executives' Ass'n*, 489 U.S. at 616.

8. *Id.*

9. Katz v. United States, 389 U.S. 347, 351-52 (1967). A governmental intrusion is deemed reasonable if the intrusion was predicated either upon the issuance of a warrant by a detached and disinterested magistrate upon a showing of probable cause, Payton v. New York, 445 U.S. 573, 582 n.17 (1979), or for compelling reasons which would justify an exception to the warrant requirement, McDonald v. United States, 335 U.S. 451, 454 (1948). *See generally* 2 WAYNE LAFAVE, SEARCH AND SEIZURE: A TREATISE ON THE FOURTH AMENDMENT (2d ed. 1987) (discussing the Fourth Amendment in detail).

10. *Katz*, 389 U.S. at 361 (Harlan, J., concurring).

1. The Fourth Amendment in the Criminal Search Context

An intrusion is reasonable in the criminal search context when a warrant[11] to search is issued based upon a showing of probable cause and a description of the things or people to be seized.[12] Once presented with an affidavit explaining, with particularity, the reasons for the intrusion and a description of the premises, a neutral and detached magistrate signs a court order issuing the warrant.[13] Probable cause to search exists when the facts and circumstances would cause a man of reasonable caution to believe that seizable objects are located in the place to be searched.[14]

The Court, however, carves out various exceptions to the warrant and probable cause elements of the reasonableness requirement, which apply in certain instances. The Court has not mandated warrants in searches: (1) while in hot pursuit of a criminal suspect;[15] (2) if there is imminent destruction of evidence;[16] (3) of automobiles;[17] (4) of items in plain view when an officer is already at a lawful vantage point;[18] (5) incident to a lawful arrest;[19] (6) of inventory pursuant to an arrest;[20] (7) where consent has been given;[21] and (8) where probable cause is impracticable because the purpose of the search is to satisfy some special need beyond law enforcement.[22] Furthermore, in other

---

11. "A warrant assures the citizen that the intrusion is authorized by law, and that it is narrowly limited in its objectives and scope." *Railway Labor Executives' Ass'n*, 489 U.S. at 622; *see* United States v. Place, 462 U.S. 696, 701 (1983) (stating that a seizure of personal property is per se unreasonable when accomplished without a judicial warrant issued upon probable cause and particularly describing items to be seized); Payton v. New York, 445 U.S. 573, 586 (1980) (stating that searches and seizures within a home without a warrant are presumptively unreasonable).

12. U.S. CONST. amend. IV.

13. Johnson v. United States, 333 U.S. 10, 13-15 (1948).

14. New Jersey v. T.L.O., 469 U.S. 325, 363-64 (1985) (citing Carroll v. United States, 267 U.S. 132, 161 (1925)).

15. Warden, Maryland Penitentiary v. Hayden, 387 U.S. 294, 305 (1967).

16. Schmerber v. California, 384 U.S. 757, 770 (1966) (holding that the need for evidence of blood alcohol content, given the rate at which the body metabolizes alcohol, and the fact that the arresting officer incurred delays in seeking medical treatment for the petitioner, justified taking a blood sample without a warrant).

17. Carroll v. United States, 267 U.S. 132, 154-55 (1925) (holding that officers are indemnified for stopping and seizing automobiles reasonably believed to be illegally transporting contraband liquor).

18. Coolidge v. New Hampshire, 403 U.S. 443, 465 (1971).

19. United States v. Robinson, 414 U.S. 218, 224 (1973) (noting that this exception extends to searches of the person and to the area within the person's control being arrested).

20. Colorado v. Bertine, 479 U.S. 367, 371-73 (1987) ("[A]n inventory search may be reasonable under the Fourth Amendment even though it is not conducted pursuant to a warrant based on probable cause."); Illinois v. Lafayette, 462 U.S. 640, 643 (1983) ("[T]he inventory search constitutes a well-defined exception to the warrant requirement.").

21. Schneckloth v. Bustamonte, 412 U.S. 218, 219 (1973); Davis v. United States, 328 U.S. 582, 593-94 (1946).

22. CHARLES WHITEBREAD & CHRISTOPHER SLOBOGIN, CRIMINAL PROCEDURE 144-293 (1986); Greg Knopp et al., *Warrantless Searches and Seizures*, 83 GEO. L.J. 692, 692 (1995). For minimally intrusive searches, the Court reasons that a lesser degree of suspicion could still satisfy the Fourth Amendment's ultimate mandate of "reasonableness." It would be excessive for the Court to require a warrant, for example, every time a police officer briefly asks minimally intrusive questions of a person exhibiting suspicious behavior. *See* Terry v. Ohio, 392 U.S. 1 (1968). Because the warrant exceptions grant police officers wide discretion, the Court created the exclusionary rule to deter officers from abusing the exceptions. United States v. Calandra, 414 U.S. 338, 347-48 (1974).

instances, the Court employs a balancing test,[23] permitting searches and seizures on a showing of less than probable cause, allowing reasonable suspicion to sometimes suffice.[24] The Court balances the government's interests in maintaining societal order and providing effective law enforcement against the relative intrusiveness to the individual.[25]

2. The Fourth Amendment in the Administrative Search Context

Administrative searches, also called regulatory, civil, or "special needs" searches, can occur in a variety of contexts, and the intrusiveness of such searches can range from minimal to highly invasive.[26] As in the criminal context, these searches, too, can occur with or without a warrant and with or without individualized suspicion. Administrative searches sometimes do not require a warrant, because the purposes of a warrant would not be furthered.[27] Ordinarily, a warrant is only useful for law enforcement purposes, in which a full criminal search targets specific individuals.[28] In an administrative search, however, the goal is not law enforcement, but some other public policy goal.[29] For instance, the goal of municipal fire, health, and housing inspec-

---

23. Camara v. Municipal Court, 387 U.S. 523, 536-37 (1967).

24. *Id.* at 538; *see also Terry*, 392 U.S. at 21-22 (sanctioning the use of a balancing test to replace individualized suspicion).

25. *Camara*, 387 U.S. at 534-37; *see Terry*, 392 U.S. at 21-25 (discussing the use of a balancing test).

26. *See* Vernonia School District 47J v. Acton, 115 S. Ct. 2386, 2393 (1995) (deeming random urinalysis drug testing of students who participate in athletics programs as an administrative search); Skinner v. Railway Labor Executives' Ass'n, 489 U.S. 602, 620-21, 630 (1989) (finding drug and alcohol testing authorized by Federal Railroad Administration regulations to be administrative search); National Treasury Employees Union v. Von Raab, 489 U.S. 656 (1989) (finding United States Custom Service's drug testing of employees applying for promotion to positions which involve stopping transportation of illegal drugs or requiring them to carry firearms at nation's borders to be administrative search); New York v. Burger, 482 U.S. 691 (1987) (finding warrantless administrative search of junkyard); United States v. Martinez-Fuerte, 428 U.S. 543 (1976) (holding vehicle stop at fixed checkpoint, Mexico-U.S. border, to determine citizenship to be administrative search); Lesser v. Epsy, 34 F.3d 1301 (7th Cir. 1994) (finding warrantless administrative search of animal dealer facilities); United States v. Branson, 21 F.3d 113 (6th Cir.) (finding warrantless administrative search of auto repair shop), *cert. denied*, 115 S. Ct. 223 (1994); *In re* Kelly-Springfield Tire Co., 13 F.3d 1160 (7th Cir. 1994) (noting administrative search conducted on showing that OSHA violated); Winters v. Board of County Comm'rs, 4 F.3d 848, 853 (10th Cir. 1993) (finding warrantless administrative search of pawn shop), *cert. denied*, 114 S. Ct. 1539 (1994); United States v. Seslar, 996 F.2d 1058, 1063 (10th Cir. 1993) (deeming warrantless random stop of trucks to determine whether trucks carrying commercial load as administrative search); United States v. Johnson, 994 F.2d 740 (10th Cir. 1993) (noting administrative search of taxidermy shop); Schaill v. Tippecanoe County Sch. Corp., 864 F.2d 1309 (7th Cir. 1988) (holding random urinalysis testing of students who participate in interscholastic sports to be administrative search); Brooks v. East Chambers Consol. Indep. Sch. Dist., 730 F. Supp. 759, (S.D. Tex. 1989), *aff'd*, 930 F.2d 915 (5th Cir. 1991) (holding urinalysis drug testing of students participating in extra-curricular activities to be administrative search).

27. The Court analyzes the public interest involved:

> In assessing whether the public interest demands creation of a general exception to the Fourth Amendment's warrant requirement, the question is not whether the public interest justifies the type of search in question, but whether the authority to search should be evidenced by a warrant, which in turn depends in part upon whether the burden of obtaining a warrant is likely to frustrate the governmental purpose behind the search.

Camara, 387 U.S. at 533.

28. *Railway Labor Executives' Ass'n*, 489 U.S. at 619.

29. *Railway Labor Executives' Ass'n*, 489 U.S. at 606-09; *Von Raab*, 489 U.S. at 660-61;

tions is public safety;[30] likewise, railroad employees and U.S. Customs Service employees may be subject to drug and alcohol testing in the interest of public safety.[31]

a. *The Warrant & Probable Cause Requirements*

A warrant supported by probable cause may be issued in an administrative context. Unlike the criminal arena, however, administrative searches typically are not subjected to a neutral, detached evaluation because the persons searched are given notice that they are subject to such random searches.[32] Either a person has signed a consent form at some point prior to the search,[33] or the very nature of the person's environment provides a lesser expectation of privacy.[34] In these instances, the need to check an arbitrary abuse of government discretion—the purpose of a warrant—is eliminated. Courts justify this exception because random searches promote the special benefits of deterrence and accuracy. These benefits may be lost during the time necessary to procure a warrant.[35] If the search is reasonable, therefore, a warrant requiring probable cause is not necessary to conduct an administrative search.

b. *The Reasonableness Balancing Test*

In the absence of a warrant or individualized suspicion, both criminal and administrative searches can require a balancing of interests in determining whether or not a search is reasonable. The Court again balances the privacy and security interests of the individual against the government's interest in conducting the search.[36] In the criminal context, the government seeks individual convictions; whereas in the administrative context, the government seeks to uphold a regulation or policy providing for public safety.[37] An important distinction between administrative and criminal searches is that in an administrative search, the government's interests are not driven by law enforcement purposes. Because the government interest is clear, the Court has an easier time fashioning the appropriate balancing test.[38] The reasonableness balancing test required for criminal searches is clearly distinguishable from the

---

Camara, 387 U.S. at 533.

30. *Camara*, 387 U.S. at 533-34.

31. *Railway Labor Executives' Ass'n*, 489 U.S. at 606-09; *Von Raab*, 489 U.S. at 660-61.

32. *Railway Labor Executives' Ass'n*, 489 U.S. at 622.

33. *Acton*, 115 S. Ct. at 2389.

34. *Id.* at 2392-93; *Railway Labor Executives' Ass'n*, 489 U.S. at 628; *Von Raab*, 489 U.S. at 672; New Jersey v. T.L.O., 469 U.S. 325, 348 (1985).

35. *See Railway Labor Executives' Ass'n*, 489 U.S. at 623; *T.L.O.*, 469 U.S. at 340; Donovan v. Dewey, 452 U.S. 594, 603 (1981); *Camara*, 387 U.S. at 533.

36. *Railway Labor Executives' Ass'n*, 489 U.S. at 606-09; *Von Raab*, 489 U.S. at 660-61.

37. *See, e.g., Railway Labor Executives' Ass'n*, 489 U.S. at 606-09 (discussing the public policy goal of preventing alcohol and drug use by railroad employees, which had possibly caused or contributed to a significant number of train accidents); *Von Raab*, 489 U.S. at 660-61 (discussing the public policy goal of preventing drug use by front line, drug interdiction Customs agents).

38. *Railway Labor Executives' Ass'n*, 489 U.S. at 606-09, 620-21; *Von Raab*, 489 U.S. at 660-61; *see Camara*, 387 U.S. at 529.

reasonableness balancing test employed by the courts in administrative searches.[39]

c. *Application of the Reasonableness Balancing Test*

In order to apply a reasonableness analysis in an administrative search context, the Fourth Amendment first requires that a search occur.[40] In the absence of a warrant, the search must then be distinguished from a criminal search.[41] To determine if a search is administrative rather than criminal, courts examine several factors. One characteristic demonstrating this difference is the randomness of administrative searches, which means a low probability for an abuse of discretion. Another is that the environment in which the search is conducted merits a lower expectation of privacy. An additional distinguishing characteristic of administrative searches is that the persons to be searched have notice of the policy. Fourth, the purposes of requiring a warrant are not served in the administrative context. Fifth, and perhaps most important, is that such a search does not further a criminal investigation; therefore, the government's interests go beyond normal law enforcement.

The final requirement of the reasonableness analysis is that the government action be reasonable.[42] Reasonableness "depends on all of the circumstances surrounding the search or seizure and the nature of the search or seizure itself."[43] If the degree of invasion is outweighed by the government's need to search, the search is likely to be found reasonable.[44] In making this determination, it appears as though the Court has employed two standards of review which can be labeled as: (1) legitimate interests, which satisfy minimally intrusive searches;[45] and (2) compelling interests, which justify highly

---

39. *Railway Labor Executives' Ass'n*, 489 U.S. at 606-09; *Von Raab*, 489 U.S. at 660-61; *see Camara*, 387 U.S. at 529.

40. *See Railway Labor Executives' Ass'n*, 489 U.S. at 614-18; *Von Raab*, 489 U.S. at 664-65; *see also* California v. Greenwood, 486 U.S. 35 (1988) (finding that a search of trash did not constitute a search); California v. Ciraolo, 476 U.S. 207 (1986) (finding that an aerial search did not contitute a search). As stated above, a search is an infringement on an expectation of privacy that society is prepared to recognize as reasonable. *Railway Labor Executives' Ass'n*, 489 U.S. at 616; *see, e.g., Greenwood*, 486 U.S. at 43; United States v. Jacobsen, 466 U.S. 109, 113 (1984). This means that a government actor must invade a person's reasonable expectation of privacy. While the Fourth Amendment applies to federal actors, it also applies to state actors through the Fourteenth Amendment. The Fourteenth Amendment, therefore, prohibits an unreasonable invasion of a person's reasonable expectation of privacy by state officials. *See* Elkins v. United States, 364 U.S. 206, 213 (1960); *see also* Wolf v. Colorado, 338 U.S. 25, 27-28 (1949) (determining that the Constitution, by virtue of the Fourteenth Amendment, prohibits unreasonable searches and seizures by state officers).

41. *Railway Labor Executives' Ass'n*, 489 U.S. at 620-21 (quoting Griffin v. Wisconsin, 483 U.S. 868, 873-74 (1987)) (stating that there are "'special needs' beyond normal law enforcement that may justify departures from the usual warrant and probable-cause requirements").

42. *See id.* at 624-34.

43. *Id.* at 619 (citing United States v. Montoya de Hernandez, 473 U.S. 531, 537 (1985)).

44. *See id.*

45. *See* United States v. Martinez-Fuerte, 428 U.S. 543 (1976) (upholding the detection and detention of illegal aliens through checkpoint border stops).

In *Martinez-Fuerte*, government officials were permitted to stop, question, and visually inspect the exterior of any vehicle. *Id.* at 558. However, the officials were not permitted to search the interior of the vehicle or the occupants. *Id.* The Court reasoned that the heavy flow of traffic

intrusive searches.[46]

B. *The Development of the Compelling Interest & Highly Intrusive Standard of Review*

1. *Skinner v. Railway Labor Executives' Ass'n*[47]

Faced with the possibility that alcohol and drug abuse by railroad employees caused or contributed to a significant number of train accidents, the Federal Railroad Administration (FRA) promulgated regulations[48] mandating blood and urine toxicological tests of all employees involved in a "major train accident."[49] Under these regulations, the railroad has the additional duty "of collecting samples for testing after an 'impact accident.'"[50] Following an occurrence that triggers the railroad's duty to test, all crew members and covered employees directly involved in the accident are taken to an independent medical facility for the collection of blood and urine samples.[51] After collecting the samples, the railroad sends them by prepaid air freight to the FRA laboratory for analysis.[52]

The FRA also adopted regulations authorizing, but not requiring, railroads to conduct breath and urine tests where, after a reportable accident or incident, a supervisor has "reasonable suspicion" that an employee's acts or omissions

---

at the border justified stopping each car without reasonable suspicion. *Id.* at 557. In addition, the Court recognized that the government's goal of deterring aliens at the border furthered the purposes of conducting random searches. *Id.* To make this determination, the Court balanced what they believed to be a minimal intrusion on the motorists' privacy, with the effectiveness of the program, the ineffectiveness of alternatives, and the legitimate interests of society in controlling the flow of illegal aliens into this country. *Id.* at 556-57; *see also* Delaware v. Prouse, 440 U.S. 648, 663 (1979) (finding the questioning of all oncoming traffic at roadblock-type stops to be a minimally intrusive method to promote the government's interest in maintaining highway safety); *Camara*, 387 U.S. at 538 (authorizing suspicionless searches of residential and commercial buildings for fire, health, and safety violations). In *Prouse*, the Court found the intrusion of stopping an automobile and detaining the driver in order to check his or her driver's license and the registration of the automobile to be an unreasonable intrusion when the driver is subsequently indicted for illegal possession of a controlled substance in the absence of reasonable suspicion that a motorist is unlicensed, or that an automobile is not registered. *Prouse*, 440 U.S. at 663. The Court did sanction states for stopping and questioning all oncoming traffic at roadblock-type stops even though they involved less intrusion. *Id.*

46. *See* Skinner v. Railway Labor Executives' Ass'n, 489 U.S. 602 (1989) (finding testing of railroad employees for drug use by urinalysis to be a highly intrusive invasion of privacy, yet justified because of the government's compelling interest in preventing catastrophic train accidents involving substantial casualties); National Treasury Employees Union v. Von Raab, 489 U.S. 656 (1989) (finding the testing of United States Customs Service employees for drug use by urinalysis to be a highly intrusive invasion of privacy, yet justified because of the government's compelling interest in promoting safety and national security).

47. 489 U.S. 602 (1989).

48. 49 C.F.R. § 219.101-.905 (1994).

49. *Railway Labor Executives' Ass'n*, 489 U.S. at 609. Under the regulations, the definition of a "major train accident" is any train accident involving "(i) a fatality, (ii) the release of hazardous material accompanied by an evacuation or a reportable injury, or (iii) damage to railroad property of $500,000 or more." *Id.* (citing 49 C.F.R. § 219.201(a)(1) (1987)).

50. *Id.* An "impact accident is a collision that results in a reportable injury, or in damage to railroad property of $50,000 or more." *Id.* (citing 49 C.F.R. § 219.201(a)(2) (1987)).

51. *Id.*

52. *Id.* at 610 (citing 49 C.F.R. § 219.205(d) (1987)).

contributed to the incident or to the severity of the accident.[53] In addition, the railroad administers these tests to employees who violate specific safety rules.[54] In all situations, the samples are only tested for alcohol and drug use, and not for any other medical information.[55] Significantly, the Court noted that although test results are not intended to be released to drug enforcement officials, the regulations do not expressly prohibit the release of such results.[56]

In reviewing the constitutionality of these regulations, the Court scrutinized the level of intrusion involved. The Court initially determined that the collection and testing of urine intruded upon expectations of privacy that society recognizes as reasonable, because the invasion affected the privacy interests of the employees' bodies.[57] However, the Court continued to discount this expectation by finding that the employees tested pursuant to these regulations have long been the focus of regulatory concern, and that they therefore possessed a diminished expectation of privacy.[58] In balancing this intrusion with the government's "compelling"[59] interest in preventing disastrous train accidents involving great human loss, the Court reasoned that the government interest outweighed the intrusion.[60] The Court found persuasive FRA statistics demonstrating the high incidence of drug and alcohol abuse in the industry, the FRA's estimations concerning the extent of property damage, and the number of fatalities and injuries caused by such abuses.[61] Likewise, the Court

---

53. *Id.* at 611 (citing 49 C.F.R. § 219.301(b)(2) (1987)).

54. *Id.* (citing 49 C.F.R. § 219.301(b)(3) (1987)). Sub-part D of the regulations, entitled "Authorization to Test for Cause," also provides that a breath test may be conducted where a supervisor has a "reasonable suspicion" that an employee is under the influence of alcohol, based upon personal observations of the employee's appearance, behavior, speech, or body odor. *Id.* (quoting 49 C.F.R. § 219.301(b)(1) (1987)). If impairment is suspected, urine tests may be required, but only if the decision to conduct such a test is made by two supervisors. *Id.* (citing 49 C.F.R. § 219.301(c)(2)(i) (1987)). Lastly, if drugs are suspected of causing impairment, one of the supervisors making the determination must be specially trained in detecting drug intoxication. *Id.* (citing 49 C.F.R. § 219.301(c)(2)(ii) (1987)).

55. *Id.* at 626.

56. *Id.* at 621 n.5 (stating that although the biological samples had never been released and are not intended for release to drug enforcement officials, the procedures do not expressly prohibit such release). In dicta, the Court implied that release to law enforcement authorities was unlikely. *Id.* at 621.

57. *Id.* at 617.

58. *Id.* at 628.

59. *Id.*

60. *Id.* at 633.

61. *Id.* at 607. The Court referenced a study conducted by the FRA:

> The FRA noted that a 1979 study examining the scope of alcohol abuse on seven major railroads found that "[a]n estimated one out of every eight railroad workers drank at least once while on duty during the study year." In addition, "5% of workers reported to work 'very drunk' or got 'very drunk' on duty at least once in the study year," and "13% of workers reported to work at least 'a little drunk' one or more times during that period." The study also found that 23% of the operating personnel were "problem drinkers," but that only 4% of these employees "were receiving help through an employee assistance program, and even fewer were handled through disciplinary procedures."

Id. at 607 n.1 (citations omitted). The FRA also reported that:

> [A]fter a review of accident investigation reports from 1972 to 1983, "the nation's railroads experienced at least 21 significant train accidents involving alcohol or drug use as a probable cause or contributing factor," and that these accidents "resulted in 25 fatalities, 61 non-fatal injuries, and property damage estimated at $19 million (approximately

viewed the ineffectiveness of previous attempts to control such abuses as dispositive of the reasonableness of maintaining these regulations.[62] In a 6-2 decision upholding the constitutionality of the alcohol and drug testing regulations, the Court held that under the totality of the circumstances, the search of the employees satisfied the Fourth Amendment's reasonableness test.[63]

2. *National Treasury Employees Union v. Von Raab*[64]

Decided the same day as *Railway Labor Executives' Ass'n*, *Von Raab* also involved drug testing.[65] However, the program involved United States Customs Service employees.[66] In implementing the drug testing program, the Commissioner of Customs authorized testing only for employees in positions meeting one or more of three criteria: (1) employment involving front line drug interdiction, (2) the possession of a firearm, or (3) the handling of "classified" material.[67] After an employee qualifies for a position covered by the

---

$27 million in 1982 dollars)."

Id. at 607 (citations omitted).

62. *Id.* at 607-08.

63. *Id.* at 634. Justices Marshall and Brennan dissented. *Id.* at 635-55. The dissent strongly criticized the majority's cursory treatment of the Fourth Amendment's requirements. *Id.* at 637. They argued that the majority unjustifiably dispensed with the probable cause requirement for the search at issue. "Without the content which [that provision gives] to the Fourth Amendment's overarching command that searches and seizures be 'reasonable,' the Amendment lies virtually devoid of meaning, subject to whatever content shifting judicial majorities, concerned about the problems of the day, choose to give to that supple term." *Id.*

Likewise, the dissent scrutinized the majority's insistence on widening the "special needs" exception to the probable cause requirement. *Id.* at 640-41. Justice Marshall asserted that in doing so, the majority had undertaken the final and necessary steps toward eliminating the probable cause requirement altogether. *Id.* at 640. "[T]he majority substitutes a manipulable balancing inquiry under which, upon the mere assertion of a 'special need,' even the deepest dignitary and privacy interests become vulnerable to governmental incursion." *Id.* at 640-41. The dissent maintained that the majority was interested only in results:

> The fact is that the malleable "special needs" balancing approach can be justified only on the basis of the policy results it allows the majority to reach. The majority's concern with the railroad safety problems caused by drug and alcohol abuse is laudable; its cavalier disregard for the text of the Constitution is not. There is no drug exception to the Constitution . . . .

Id. at 641. "Constitutional requirements like probable cause are not fair-weather friends, present when advantageous, conveniently absent when 'special needs' make them seem not." *Id.* at 637.

Finally, the dissent suggested that the majority should have evaluated the FRA's testing regime by using the traditional analytical framework condoned by the Court in cases involving full-scale searches implicating the Fourth Amendment. *Id.* at 641-48. Specifically, Justice Marshall commented that the majority should have first asked whether a search had taken place. *Id.* at 641-42. Second, they should have inquired as to "whether the search was based on a valid warrant or undertaken pursuant to a recognized exception to the warrant requirement." *Id.* at 642. Next, the Court should have asked "whether the search was based on probable cause or validly based on lesser suspicion because it was minimally intrusive." *Id.* Justice Marshall remarked that the final question should have been whether the search was conducted in a reasonable manner. *Id.*

The dissent concluded that the majority's constitutional framework for allowing such a search was devoid of the "time-honored and textually based principles" which the Framers intended to include in the Fourth Amendment. *Id.* at 654-55.

64. 489 U.S. 656 (1989).

65. *Von Raab*, 489 U.S. at 660.

66. The United States Customs Service is a bureau of the Department of Treasury. *Id.* at 659.

67. *Id.* at 660-61. The Court reasoned that because the Customs Service is the nation's first line of defense against the smuggling of illicit narcotics into the country, they could not perform

Service's testing program, the Service advises the employee that final selection is contingent upon satisfying the drug test.[68] An independent contractor then contacts the employee to arrange a time and place for producing and collecting the urine sample.[69] The contractor then tests the sample for the presence of marijuana, cocaine, opiates, amphetamines, and phencyclidine.[70] If an initial screening test produces a positive result, the contractor conducts a second test to confirm those results.[71] If that test verifies the positive result, the contractor notifies the Agency, and the Agency dismisses the employee from the Service.[72] Unlike the regulations in *Railway Labor Executives' Ass'n*, however, the Court maintained that the Customs Service's rules expressly prohibited the release of test results to law enforcement authorities.[73]

In analyzing the Customs Service's drug testing program, the Court first acknowledged that the program implicated the Fourth Amendment, since the tests invaded reasonable expectations of privacy.[74] Next, because the intrusion on the Custom Service's employees served special governmental needs beyond the normal need for law enforcement, the Court applied the Fourth Amendment balancing test for administrative searches.[75] The Court then balanced the employee's privacy expectations against the government's interest.[76] The Court's analysis focused on the fact that the Customs Service is the nation's first line of defense against the smuggling of illicit narcotics into the country.[77] Therefore, the Court reasoned that a drug abusing front-line Customs employee is susceptible to bribes and blackmail against the government, risking "extraordinary safety and national security hazards."[78] Additionally, the Court determined that an armed Customs Service agent with impaired perception posed a further danger to the general public.[79]

The government provided no evidence of an existing drug problem among employees, nor did they contend that they even perceived such a problem.[80]

---

such a vital task for this country if they were abusing drugs. *Id.*

68. *Id.* at 661.

69. *Id.* Upon producing the sample, the employee signs a chain-of-custody form, the monitor initials the form, seals the sample in a plastic bag, and sends it to a laboratory. *Id.*

70. *Id.* at 662. Phencyclidine is an anesthetic used in veterinary medicine, which is also used illegally as a hallucinogen. It causes elevated blood pressure, rapid pulse, increased skeletal muscle tone, and occasionally myoclonic jerks. AM. JUR. PROOF OF FACTS, CYCLOPEDIC MEDICAL DICTIONARY 1383 (3d ed. 1989) It is also referred to as "PCP or angel dust." *Id.*

71. *Id.* Confirmed positive results are reported to a "Medical Review Officer," defined as "'[a] licensed physician . . . who has knowledge of substance abuse disorders and has appropriate medical training to interpret and evaluate an individual's positive test result together with his or her medical history, and any other relevant biomedical information.'" *Id.* at 662-63 (quoting Mandatory Guidelines for Federal Workplace Drug Testing Programs, 53 Fed. Reg. 11,970, 11,980 (1988)).

72. *Von Raab*, 489 U.S. at 663.

73. *Id.*

74. *Id.* at 665.

75. *Id.* This was the same test adopted in *Railway Labor Executives' Ass'n*, 489 U.S. at 619-20. *Von Raab*, 489 U.S. at 665.

76. *Von Raab*, 489 U.S. at 665.

77. *Id.* at 668. The Court identified such smuggling as a "veritable national crisis" in law enforcement. *Id.* (citing United States v. Montoya de Hernandez, 473 U.S. 531, 538 (1985)).

78. *Id.* at 674.

79. *Id.* at 671.

80. *Id.* at 673.

Nonetheless, the Court held that the government's interest in ensuring that front line interdiction customs agents are physically fit and possess unimpeachable integrity and judgment,[81] was compelling enough to justify such an intrusion.[82]

The Court next explained why customs employees have a diminished expectation of privacy because of the nature of their positions within the Service.[83] The Court reasoned that employees involved in drug interdiction should expect such an invasion of privacy, because their health and fitness bear directly on their ability to perform sensitive duties.[84]

In balancing both interests, the Court concluded that the government's compelling interests outweighed the privacy interests of the Customs Service employees.[85] Thus, in a 5-4 decision, the Court held that the Customs Service's drug testing program met the reasonableness requirement of the Fourth Amendment.[86]

---

81. *Id.* at 670.
82. *Id.* at 672.
83. *Id.*
84. *Id.*
85. *Id.*
86. *Id.* at 679. Justice Scalia, joined by Justice Stevens, dissented:

> The Court agrees that [the requirement that an employee produce excretion and give it to the government for chemical analysis] constitutes a search for purposes of the Fourth Amendment—and I think it obvious that it is a type of search particularly destructive of privacy and offensive to personal dignity.

Id. at 680. (Scalia, J., dissenting). Justice Scalia found particularly persuasive the lack of evidence demonstrating that a "real problem" of drug use existed within the Customs Service. *Id.* at 681. He continued to disparage the majority's response to this evidentiary problem when they made the blanket statement that "'[t]here is little reason to believe that American workplaces are immune from [the] pervasive social problem' of drug abuse." *Id.* at 684. Justice Scalia remarked, "[I]f such a generalization suffices to justify demeaning bodily searches, without particularized suspicion, to guard against the bribing or blackmailing of a law enforcement agent, or the careless use of a firearm, then the Fourth Amendment has become frail protection indeed." *Id.* Justice Scalia concluded by criticizing the Court's blindness toward the Government's underlying reasons for requiring such an invasive bodily intrusion:

> What better way to show that the Government is serious about its "war on drugs" than to subject its employees on the front line of that war to this invasion of their privacy and affront to their dignity? . . . I think it obvious that this justification is unacceptable; that the impairment of individual liberties cannot be the means of making a point; that symbolism, even symbolism for so worthy a cause as the abolition of unlawful drugs, cannot validate an otherwise unreasonable search . . . . Those who lose because of the lack of understanding that begot the present exercise in symbolism are not just the Customs Service employees, whose dignity is thus offended, but all of us—who suffer a coarsening of our national manners that ultimately give the Fourth Amendment its content, and who become subject to the administration of federal officials whose respect for our privacy can hardly be greater than the small respect they have been taught to have for their own.

Id. at 686-87. Justice Marshall, joined by Justice Brennan, also dissented. ("Here, as in Skinner, the Court's abandonment of the Fourth Amendment's express requirement that searches of the person rest on probable cause is unprincipled and unjustifiable.") *Id.* at 679-80 (Marshall, J., dissenting).

3. *New Jersey v. T.L.O.*[87]

In *T.L.O.*, the Court upheld the constitutionality of a high school principal's warrantless search of a student's purse without probable cause.[88] The search was precipitated by a teacher observing the student smoking in a school lavatory.[89] The teacher took T.L.O. to the principal's office because smoking in the lavatories violated a school rule.[90] Once in the office, the assistant vice principal questioned T.L.O. about whether she had been smoking.[91] T.L.O. denied that she had been smoking, and claimed she did not smoke at all.[92] After this brief questioning, the principal asked T.L.O. to go into his private office, where he searched her purse and found a pack of cigarettes.[93] As he reached into the purse for the cigarettes, he also noticed a package of cigarette rolling papers.[94] At that point, the principal associated the possession of such materials with the use of marijuana.[95] Therefore, he proceeded to search T.L.O.'s purse thoroughly, intending to find further evidence of drugs.[96] The second search of a separate zippered compartment in the purse revealed a small amount of marijuana, a pipe, empty plastic bags, a number of one dollar bills, an index card which appeared to him to be a list of students owing T.L.O. money, and two letters implicating T.L.O. in the distribution of marijuana.[97] The assistant vice principal then notified T.L.O.'s mother, and turned the evidence of drug dealing over to the police.[98]

Subsequently, the police requested that T.L.O. and her mother go to police headquarters, where T.L.O. confessed to selling marijuana at school.[99] Based on the confession and the evidence seized by the assistant vice principal, the state brought delinquency charges against T.L.O. in the county juvenile court.[100] The juvenile court found the search of T.L.O.'s purse reasonable under the Fourth Amendment, and sentenced her to a year's probation.[101] An appellate court affirmed this finding.[102] T.L.O. appealed, and the Supreme

87. 469 U.S. 325 (1985).
88. *T.L.O.*, 469 U.S. at 328.
89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.*
100. *Id.* at 329. The principal also suspended T.L.O. for three days for smoking in a nonsmoking area and seven days for possession of marijuana. *Id.* at 329 n.1. Based on T.L.O.'s motion, the Superior Court of New Jersey, Chancery Division, found that the principal seized the evidence of marijuana in violation of the Fourth Amendment, and thus, the court set aside the seven-day suspension. *Id.* (citing T.L.O. v. Piscataway Bd. of Educ., No. C.2865-79 (N.J. Super. Ct. Ch. Div., Mar. 31, 1980)).
101. *Id.* at 329-30.
102. *Id.* at 330. The appellate court afffirmed the lower court's finding that there had been no Fourth Amendment violation. It vacated, however, the adjudication of the delinquency conviction and remanded for a determination as to whether T.L.O. had knowingly and voluntarily waived her Fifth Amendment rights before confessing. *Id.*

Court of New Jersey reversed, ordering the suppression of the evidence seized from T.L.O.'s purse.[103] New Jersey then petitioned for and was granted certiorari in the United States Supreme Court.[104]

In its opinion, the Court recognized that the Fourth Amendment prohibits unreasonable searches and seizures by public school officials.[105] The Court focused next on balancing T.L.O.'s legitimate expectations of privacy and personal security against the school's need to maintain order[106] and an environment conducive to learning.[107] Acknowledging the value of preserving the informality of the student-teacher relationship[108] and the need for swift discipline in schools,[109] the Court concluded that while students have an expectation of privacy, they nonetheless have a diminished one.[110] Since the principal searched the zippered compartment with individualized suspicion of criminal activity, and the intent to further law enforcement goals, the Court analyzed the intrusion as a criminal, rather than an administrative search.[111] The Court first examined "'whether the . . . action was justified at its inception.'"[112] Second, the Court examined whether the search "'was reasonably related in scope to the circumstances which justified the interference in the first place.'"[113]

In applying this test, the Court considered how T.L.O. had been accused of smoking, and had denied the accusation.[114] The Court explained that under those circumstances, a determination of whether T.L.O. possessed cigarettes

---

103. *Id.*

104. *Id.* at 331.

105. *Id.* at 333-34. The Court further stated, "'[T]he basic purpose of [the Fourth] Amendment . . . is to safeguard the privacy and security of individuals against arbitrary invasions by government officials.'" *Id.* at 335 (quoting Camara v. Municipal Court, 387 U.S. 523, 528 (1967)).

The Court determined that since school officials are subject to the commands of the First Amendment and the Due Process Clause of the Fourteenth Amendment, the concept of school officials acting as parents, and not as the state, when they search students "is in tension with contemporary reality and the teachings of [the] Court." *Id.* at 336. "[T]he Court has recognized that 'the concept of parental delegation' as a source of school authority is not entirely 'consonant with compulsory education laws.'" *Id.* (quoting Ingraham v. Wright, 430 U.S. 651, 662 (1977)). *See generally* 59 AM. JUR. 2D *Parent and Child* §§ 10-22, at 75-76 (1987) (describing the rights, duties, and authority of parents over their children, and the rights, duties, and authority of persons acting *in loco parentis*).

106. *T.L.O.*, 469 U.S. at 341.

107. *Id.* at 340; *see* Knopp et al., *supra* note 22, at 763-64 (discussing how the Court allowed the state to dispense with the warrant and probable cause elements when special needs exist, and instead, balanced the government's interests against the intrusion on individual privacy).

108. *T.L.O.*, 469 U.S. at 340.

109. *Id.* at 329.

110. *See id.* at 339-40. In striking the balance, the Court determined that in the school setting, the restrictions to which searches by public authorities are ordinarily subject require some easing. *Id.* at 340. In addition, the Court noted that in a school setting, "some modification of the level of suspicion of illicit activity [is] needed to justify a search." *Id.*

111. *See id.* at 341.

112. *Id.* at 341 (quoting Terry v. Ohio, 392 U.S. 1, 20 (1968)). The Court stated that "a search of a student by a teacher or other school official will be 'justified at its inception' when there are reasonable grounds for suspecting that the search will turn up evidence that the student has violated or is violating either the law or the rules of the school." *Id.* at 341-42.

113. *Id.* at 341 (quoting *Terry*, 392 U.S. at 20).

114. *Id.* at 345.

was relevant to the charges against her.[115] Possession of cigarettes by T.L.O., the Court reasoned, would both corroborate the accusation that T.L.O. had been smoking and undermine the credibility of T.L.O.'s defense to the charge of smoking.[116] Thus, the Court determined that if the assistant vice principal had a reasonable suspicion that T.L.O. had cigarettes in her purse, then the search was justified and reasonably related to the circumstances which justified the intrusion at the outset.[117]

The Court's conclusion that the first search was reasonable prompted them to analyze whether the second search for marijuana, after the pack of cigarettes was located, was reasonable.[118] The Court found that the discovery of the rolling papers gave rise to a reasonable suspicion that T.L.O.'s purse contained marijuana, which in turn allowed the assistant vice principal to search T.L.O.'s purse further.[119] The Court concluded that it was not unreasonable to extend the search to a separate zippered compartment of the purse and examine the contents of that compartment.[120] Therefore, the search of T.L.O.'s purse was reasonable under the Fourth Amendment.[121]

II. *VERNONIA SCHOOL DISTRICT 47J V. ACTON*[122]

A. *Facts and Procedural History*

In the fall of 1991, James Acton, then in the seventh grade, signed up to play football at his middle school.[123] However, school officials would not allow Acton to participate because Acton and his parents refused to sign consent forms authorizing the school to conduct a drug test of Acton's urine.[124] Vernonia School District 47J ("the District") operates one high school and three grade schools in the logging community of Vernonia, Oregon.[125] The District had not experienced a problem with drugs until the mid-to-late 1980s, when teachers and administrators observed a sharp increase in drug use.[126]

In support of their observations, high school teachers and administrators offered testimony that they had witnessed students discussing their attraction to the drug culture.[127] During this time, students became increasingly rude

115. *Id.*

116. *Id.* The Court stated, "The relevance of T.L.O.'s possession of cigarettes to the question whether she had been smoking and to the credibility of her denial that she smoked supplied the necessary 'nexus' between the item searched for and the infraction under investigation." *Id.*

117. *Id.* at 345-46.

118. *Id.* at 347.

119. *Id.*

120. *Id.*

121. *Id.* at 347-48.

122. 115 S. Ct. 2386 (1995).

123. *Acton*, 115 S. Ct. at 2390.

124. *Id.*

125. *Id.* at 2388. Vernonia, Oregon has a population of approximately 3,000, including those living within or near the city limits. Acton v. Vernonia Sch. Dist. 47J, 796 F. Supp. 1354, 1356 (D. Or. 1992).

126. *Acton*, 115 S. Ct. at 2388.

127. *Id.* Allegedly, the organizations which formed within the "drug culture" adopted names such as the "Big Elks" and the "Drug Cartel." *Acton*, 796 F. Supp. at 1356. "Loud 'bugling' or 'head butting' were the calling cards of these groups." *Id.*

during class, and used profanity more often.[128] This led to a drastic increase in the number of disciplinary referrals, and several students were suspended.[129]

In addition, the District believed that student high school athletes were not only involved in such drug use, but were also the leaders of the high school's "drug culture."[130] The District felt that drug use could increase "the risk of sports-related injuries."[131] For example, the high school football and wrestling coach observed "a severe sternum injury suffered by a wrestler, [as well as] various omissions of safety procedures and misexecutions by football players."[132] The coach did not attribute these incidents to other possible causes, such as aggressive play, nervousness, or mere misexecutions caused by the opponent or opposing team. Instead, he attributed the incidents to drug use.[133]

Initially, the District offered special classes, speakers, and presentations designed to educate students about the harmful effects of drug use.[134] However, after the District found these measures ineffective, they implemented a "Student Athlete Drug Policy" ("the Policy").[135] The stated purpose of the Policy was "to prevent student athletes from using drugs, to protect their health and safety, and to provide drug users with assistance programs."[136] Under the Policy, all students participating in school sponsored athletics, and their parents, are required to sign a form consenting to the student's urine testing.[137] At the beginning of the fall, winter, and spring sports seasons, the District tests athletes participating in sports for that season.[138] In addition, during each week of the season, ten percent of the athletes from the entire athletic population for that season are randomly selected for testing.[139] Athletes selected for testing are notified and tested later the same day.[140]

Before administering the tests, the District requires each student to complete a "specimen control form which bears an assigned number."[141] At this time, students must reveal all prescription medications that they are taking, and show proof by providing a copy of the prescription or a doctor's authorization.[142]

---

128. *Acton*, 115 S. Ct. at 2388.

129. *Id.* The Court recognized that "[b]etween 1988 and 1989 the number of disciplinary referrals in Vernonia schools rose to more than twice the number reported in the early 1980's." *Id.*

130. *Id.* at 2388-89 (citing *Acton*, 796 F. Supp. at 1357).

131. *Id.* at 2389.

132. *Id.*

133. *Id.*

134. *Id.*

135. The Court found that there had been "unanimous" parental approval for the Policy, which had been presented for consideration at a "parent input night." *Id.* The Policy applied to all student athletes. *Id.*

136. *Id.*

137. *Id.* "Approximately 60-65% of the high school students and 75% of the elementary school students participate in district sponsored athletics." *Acton*, 796 F. Supp. at 1356.

138. *Acton*, 115 S. Ct. at 2389.

139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.* For example, the form would require the student to reveal prescribed medication for

An individual student is then accompanied by an adult monitor of the same sex into an empty locker room, where the student produces a sample.[143] The boys produce a sample at a urinal, remaining fully clothed with their backs to the monitor.[144] The girls produce samples in an enclosed bathroom stall, where a monitor listens for the normal sounds of urination, but does not visually observe the student.[145] The monitor checks the sample for temperature and tampering.[146] The monitor then transfers the urine to a vial.[147]

Thereafter, the District sends all samples to an independent laboratory for testing.[148] The laboratory tests every sample for the presence of marijuana, cocaine, and amphetamines.[149] The District permits the laboratory to send test reports to the superintendent of the District, and to give the test results to the District by telephone "after the requesting official recites a code confirming his authority."[150] The superintendent, principals, vice-principals, and athletic directors all have access to the test results.[151]

Once a sample tests positive, the lab confirms the result by administering a second test.[152] If the sample tests negative the second time, no further action is taken.[153] However, if the sample tests positive, the school principal meets with the student and his or her parents.[154] The student then receives the option of entering a six week drug assistance program (which requires weekly urinalysis), or being suspended from athletics for the remainder of the current and next athletic seasons.[155] Students selecting the latter option are retested at the beginning of the next athletic season for which they are eligible.[156] If a student violates the policy a second time, he or she is automatically suspended from participation in athletics for the remainder of the current and next athletic seasons.[157] If a student violates the policy a third time, he or she is suspended for the current and next two athletic seasons.[158]

James Acton and his parents refused to consent to the District's drug testing procedures.[159] Instead, they filed suit in United States District Court for the District of Oregon, seeking declaratory and injunctive relief from

---

epilepsy, AIDS, or birth control pills. *See id.*

143. *Id.*

144. *Id.* The monitor stands approximately 12 to 15 feet behind the student. *Id.*

145. *Id.*

146. *Id.*

147. *Id.*

148. *Id.* "The laboratory procedures are 99.94% accurate." *Id.*

149. *Id.* "Other drugs, such as LSD, may be screened at the request of the District, but the identity of a particular student does not determine which drugs will be tested." *Id.* The identity of a student who produces a sample is not revealed to the laboratory. *Id.*

150. *Id.* Test results "are not kept for more than one year." *Id.*

151. *Id.*

152. *Id.* at 2390.

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

158. *Id.*

159. *Id.*

enforcement of the Policy, on the grounds that it violated the Fourth and Fourteenth Amendments and Article I, section 9 of the Oregon Constitution.[160] At the conclusion of a bench trial, the district court dismissed the action, denying each claim on the merits.[161] The Actons appealed the decision and the U.S. Court of Appeals for the Ninth Circuit reversed, holding that the policy violated both the Fourth and Fourteenth Amendments and the Oregon Constitution.[162] The court reasoned that the students in the Vernonia School District had legitimate expectations of privacy in their excretory functions. Further, neither a student's participation in interscholastic athletics nor a student's use of the school's locker rooms, diminished a student's expectation of privacy.[163] The court determined that the District's interest in reducing drug use was not compelling enough to justify the highly intrusive random tests of the students' urine.[164] The District appealed to the Supreme Court.

B. *Supreme Court Decision*

1. Majority Opinion

The majority opinion, written by Justice Scalia, held that the Vernonia School District's student-athlete drug policy did not violate the student's federal or state constitutional right to be free from unreasonable searches, as required by the Fourth and Fourteenth Amendments and Article I, section 9 of the Oregon Constitution.[165] First, the majority opinion acknowledged that the District had determined that athletes in Vernonia played a large role in contributing to the use of drugs in the District's high school.[166] The Court referenced several injuries sustained by high school athletes, which school officials attributed to drug use.[167] In addition, the Court noted the District's perception of a sharp increase in disciplinary problems.[168]

The Court next addressed whether under the Fourth Amendment, pursuant to the Fourteenth Amendment, the constitutional guarantee to be free from unreasonable searches and seizures extended to the actions of state officials.[169] In answering this question, the Court turned to precedent and

---

160. *Id.* The Oregon Constitution provides in pertinent part:

> No law shall violate the right of the people to be secure in their persons, houses, papers, and effects, against unreasonable search, or seizure; and no warrant shall issue but upon probable cause, supported by oath, or affirmation, and particularly describing the place to be searched, and the person or thing to be seized.

OR. CONST. art. I, § 9.

161. Acton v. Vernonia Sch. Dist. 47J, 796 F. Supp. 1354, 1368 (D. Or. 1992). The court found that the record contained "ample evidence" to substantiate the District's concern that the classroom disciplinary problems were being caused by drug and alcohol abuse. *Id.* at 1367. Additionally, the court reasoned that the program would most likely repress the District's problem. *Id.* at 1363.

162. Acton v. Vernonia Sch. Dist. 47J, 23 F.3d 1514, 1527 (9th Cir. 1994).

163. *Id.* at 1525.

164. *Id.* at 1526.

165. *Acton*, 115 S. Ct. at 2397.

166. *Id.* at 2388.

167. *Id.* at 2389.

168. *Id.* at 2388. The Court relied on the district court's assessment that "[d]isciplinary problems had reached 'epidemic proportions.'" *Id.* at 2389.

169. *Id.* at 2390 (citing Elkins v. United States, 364 U.S. 206, 213 (1960) (holding that this

concluded that the "state compelled collection and testing of urine, [as required] by the [District's] Policy constitutes a 'search' subject to the demands of the Fourth Amendment."[170]

After establishing that the District's urine collection constituted a search under the Fourth Amendment, the majority addressed whether individualized suspicion is necessary for a Fourth Amendment analysis in an administrative search context.[171] The majority conceded that *T.L.O.* was based on individualized suspicion of wrong-doing; however, the Court explained that "the Fourth Amendment imposes no irreducible requirement of such suspicion."[172] The Court noted that since its decision in *T.L.O.*, it had upheld suspicionless searches and seizures in an administrative context.[173]

The fourth issue discussed by the majority was the nature of the privacy interest involved in the search.[174] The Court emphasized that the Fourth Amendment only protects expectations of privacy that society recognizes as legitimate.[175] In analyzing the interests of the students in *Acton*, the Court noted that the reasonableness inquiry mandated by the Fourth Amendment could not "disregard the school's custodial and tutelary responsibility for children."[176] Therefore, the majority found that students have a legitimate, yet diminished, expectation of privacy.[177] Moreover, student-athletes have an even lesser expectation of privacy.[178]

---

guarantee is extended to searches and seizures by state officers)); *id.* (citing New Jersey v. T.L.O., 469 U.S. 325, 333-34 (1985) (finding that public school officials are state officers)).

170. *Id.* (citing *Railway Labor Executives' Ass'n*, 489 U.S. at 617; *Von Raab*, 489 U.S. at 665).

171. *Id.* at 2391.

172. *Id.* (citing *T.L.O.*, 469 U.S. at 340, 341).

173. *Id.* Examples cited were *Railway Labor Executives' Ass'n* for its drug testing of railroad employees involved in train accidents, and *Von Raab*'s drug testing of armed customs officials involved in drug interdiction. *Id.* Also cited were the maintainence of "automobile checkpoints looking for illegal immigrants and contraband," United States v. Martinez-Fuerte, 428 U.S. 543, 566-67 (1976), and looking for drunk drivers, Michigan Dep't of State Police v. Sitz, 496 U.S. 444, 455 (1990). *Id.*

174. *Acton*, 115 S. Ct. at 2391.

175. *Id.* (citing *T.L.O.*, 469 U.S. at 338).

176. *Id.* at 2392. "[A] proper educational environment requires close supervision of schoolchildren, as well as the enforcement of rules against conduct that would be perfectly permissible if undertaken by an adult." *Id.* (citing *T.L.O.*, 469 U.S. at 339).

177. *Id.* Interestingly, as the Court made this determination that public school officials maintain a large degree of control over the actions and conduct of students, they also explained how this does not constitutionally create a duty for those same officials to protect the students. *Id.* (citing DeShaney v. Winnebago County Dep't of Social Servs., 489 U.S. 189, 200 (1989)).

178. *Id.* at 2392-93. The majority stated:

> School sports are not for the bashful. They require "suiting up" before each practice or event, and showering and changing afterwards. Public school locker rooms, the usual sites for these activities, are not notable for the privacy they afford. The locker rooms in Vernonia are typical: no individual dressing rooms are provided; shower heads are lined up along a wall, unseparated by any sort of partition or curtain; not even all the toilet stalls have doors.

Id. Furthermore:

> By choosing to "go out for the team," [athletes] voluntarily subject themselves to a degree of regulation even higher than that imposed on students generally. In Vernonia's public schools, they must submit to a preseason physical exam, . . . they must acquire adequate insurance coverage or sign an insurance waiver, maintain a minimum grade point average, and comply with any "rules of conduct, dress, training hours and related

The majority then scrutinized the character of the intrusion posed by urinalysis.[179] The Court explained that the degree of intrusion depends on how the production and collection of the urine is monitored.[180] The Court determined that the privacy interests involved in the collection of urine samples were not significant.[181] The majority found important that under the District's policy, male students produce their samples against a wall, fully clothed, and that the female students provide their samples behind an enclosed stall.[182] Thus, these conditions are identical to those typically encountered in public rest rooms, which are used by men, women, and students on a daily basis.[183] The Court further noted that another privacy-invasive aspect of urinalysis is the information it discloses about the person's body and the materials they have ingested.[184] The majority believed this intrusion was permitted, because the urine is tested only for drugs, and not for whether the student is epileptic, pregnant, or diabetic.[185]

Finally, the majority examined the nature of the District's interests.[186] Instead of following the *Railway Labor Executives' Ass'n* and *Von Raab* requirement of a "compelling" government interest, the majority explained that this phrase "describes an interest which appears important enough to justify the particular search at hand, in light of other factors which show the search to be relatively intrusive upon a genuine expectation of privacy."[187] Therefore, the Court reasoned that whether the District's concern was important enough was of no consequence, because it had been met.[188] Furthermore, the Court explained that the individualized suspicion requirement established in *Railway Labor Executives' Ass'n* could be set aside if the District demonstrated an "immediate" concern, meaning if their concerns required prompt action.[189] The majority believed that deterring drug use by the nation's schoolchildren was important enough.[190] They did not, however, address whether the District's concerns needed to be addressed with any sort of urgency. Regard-

---

matters as may be established for each sport by the head coach and athletic director with the principal's approval."

Id. at 2393.

179. *Id.*

180. *Id.* (citing *Railway Labor Executives' Ass'n*, 489 U.S. at 626).

181. *Id.*

182. *Id.*

183. *Id.*

184. *Id.*

185. *Id. But see supra* notes 141-42 and accompanying text (explaining that students were required to disclose any medications they were taking).

186. *Acton*, 115 S. Ct. at 2394.

187. *Id.* at 2394-95.

188. *Id.* at 2395.

189. *Id.*

190. *Id.* The majority stated:

School years are the time when the physical, psychological, and addictive effects of drugs are most severe. "Maturing nervous systems are more critically impaired by intoxicants than mature ones are; childhood losses in learning are lifelong and profound"; "children grow chemically dependent more quickly than adults, and their record of recovery is depressingly poor."

Id. (quoting Richard A. Hawley, *The Bumpy Road to Drug-Free Schools*, 72 PHI DELTA KAPPAN 310, 314 (1990)).

less, the Court concluded that the nature and immediacy of the government's concerns were sufficient.[191]

In balancing the students' privacy and security interests against the District's interests, the Court found the latter to outweigh the former, and held the Policy to be "reasonable and hence constitutional."[192]

2. Concurring Opinion

Written by Justice Ginsburg, the concurring opinion agreed with the majority's decision, but questioned whether the Policy adopted by the Vernonia School District could constitutionally be imposed not only on those students seeking to engage in scholastic athletics, but on all students required to attend school.[193]

3. Dissenting Opinion

Justice O'Connor, joined by Justices Stevens and Souter, strongly dissented, criticizing the majority for ignoring the individual suspicion requirement.[194] Justice O'Connor explained that the Court overlooked this requirement on "policy grounds."[195] She admonished such an approach by stating that because blanket searches can potentially be conducted of many people, they present a greater threat to liberty than suspicion-based searches, because they affect only one person at a time.[196] However, the dissenters emphasized that whether blanket searches are better than searches based on individualized suspicion is not the issue.[197] They claimed that the decision "is not open to judges or government officials to decide on policy grounds which is better and which is worse."[198] In support of their assertion, the dissent then discussed how precedent had established that "mass, suspicionless searches [were] generally considered per se unreasonable within the meaning of the Fourth Amendment."[199] The dissenters added that while there were exceptions to this rule, such exceptions only apply when a suspicion-based regime is ineffectual.[200] Justice O'Connor concluded that this was not the situation in *Acton*.[201]

---

191. *Id.*

192. *Id.* at 2396.

193. *Id.* at 2397 (Ginsburg, J., concurring).

194. *Id.* (O'Connor, J., dissenting).

195. *Id.* "In making these policy arguments . . . the Court sidesteps powerful, countervailing privacy concerns." *Id.* "First, [the majority] explains that precisely because every student athlete is being tested, there is no concern that school officials might act arbitrarily in choosing who to test. Second, a broad-based search regime, the Court reasons, dilutes the accusatory nature of the search." *Id.*

196. *Id.* (citing Illinois v. Krull, 480 U.S. 340, 365 (1987) (O'Connor, J., dissenting)).

197. *Id.*

198. *Id.*

199. *Id.* at 2398.

200. *Id.*

201. *Id.* The dissent then detailed an historical analysis beginning with Carroll v. United States, 267 U.S. 132 (1925). Justice O'Connor stated, "The Carroll Court's view that blanket searches are 'intolerable and unreasonable' is well-grounded in history." *Acton*, 115 S. Ct at 2398. In addition, Justice O'Connor stated that this has been confirmed in an exhaustive analysis of the original meaning of the Fourth Amendment. *Id.* (citing William J. Cuddihy, The Fourth Amendment: Origins and Original Meaning (1990) (unpublished Ph.D. dissertation, Claremont Graduate

The dissenters criticized the majority's finding that accusatory suspicion-based searches are ineffectual, because it was not based on the reality of public schools.[202] The dissent noted that the District's disciplinary scheme listed many offenses that students are punished for, and therefore, suspicion-based drug testing for student athletes could easily have been added to the list.[203]

The dissent, referring to the evidence introduced by the District to justify suspicionless testing as a great irony, pointed out that such evidence consisted of stories of individual, identifiable students conducting themselves in a manner which plainly gave rise to reasonable suspicion.[204] For example, drug paraphernalia was confiscated on school grounds, and some teachers allegedly observed students using drugs at a local cafe across the street from the high school.[205] Moreover, since the impetus for the drug testing policy was to combat the rise in drug-related disorder and disruption in the classrooms, the dissent criticized the District for not simply testing those students causing the disruptions.[206] The dissent concluded that intrusive blanket searches of students—most of whom are innocent—sends the wrong message.[207]

The final issue raised by the dissent was the lack of evidence in the court record of a drug problem in the Washington Grade School which James Acton attended.[208] Indeed, three of the four witnesses who testified to drug-related incidents were teachers or coaches at the high school, and the fourth witness had been the principal at the high school prior to implementation of the Policy.[209]

The Justices concluded that "the greatest threats to our constitutional freedoms come in times of crisis,"[210] and that here, the Policy implemented by the District was too broad and imprecise to satisfy the Fourth Amendment's reasonableness analysis.[211]

III. ANALYSIS

The United States Supreme Court's decision in *Acton* is but another case which marks the erosion of the fundamental constitutional requirement that all searches satisfy the reasonableness test of the Fourth Amendment. Rather than

---

School)). The dissent noted that mass, suspicionless searches, are generally unreasonable in the criminal context. *Id.* at 2400. "As stated, a suspicion-based search regime is not just any less intrusive alternative; the individualized suspicion requirement has a legal pedigree as old as the Fourth Amendment itself, and it may not be easily cast aside in the name of policy concerns." *Id.* at 2403.

202. *Id.* at 2402-03.

203. *Id.*

204. *Id.* at 2403.

205. *Acton*, 796 F. Supp. at 1356-57.

206. *Acton*, 115 S. Ct. at 2406.

207. *Id.* at 2405. "[Suspicionless testing] sends a message to children that are trying to be responsible citizens . . . that they have to prove that they're innocent . . . , and I think that kind of sets a bad tone for citizenship." *Id.* (quoting the testimony of Acton's father, Tr. at 9 (Apr. 29, 1992)).

208. *Id.* at 2406.

209. *Id.*

210. *Id.* at 2407. The "crisis" the Justices are referring to is the District's drug problem.

211. *Id.*

protect the privacy and security interests of student athletes in the Vernonia School District, the majority authorized highly intrusive, random, suspicionless searches based on less than compelling interests.

Relying on its prior decision in *New Jersey v. T.L.O.*,[212] the *Acton* majority held that children in school have a lower expectation of privacy than other persons in our society.[213] In addition, the Court cited *T.L.O.* for the proposition that "special needs" exist in the public school setting, thereby alleviating the practicability of a warrant.[214] Justice Scalia concluded that because the Court in *T.L.O.* authorized a warrantless search of a high school student's purse without probable cause, the search in *Acton* had to be upheld because the District's twofold interest—maintaining order and discipline in the classroom and athletic safety—outweighed the privacy and security interests of the students.[215] This misinterpretation resulted in a violation of the Vernonia student-athletes' constitutional right to be free from unreasonable searches under the Fourth Amendment.

At first glance, *T.L.O.* appears relevant to the Court's reasoning and decision in *Acton*.[216] The Court certainly relied on *T.L.O.* when deciding the constitutionality of the drug testing program at issue in *Acton*.[217] *T.L.O.* involved a search of a student,[218] and the degree of privacy accorded students.[219] Since *Acton* also involved a search of a student, *T.L.O.* would seem controlling. However, while *T.L.O.* is instructive regarding the expectations of privacy in a school environment, a close examination of *T.L.O.* demonstrates that the two cases have different legal significance.

The majority's reliance on *T.L.O.* is misplaced. *T.L.O.* involved a criminal search; *Acton*, however, involved an administrative case. Although the search of a purse in *T.L.O.* was highly intrusive, it nonetheless was not random or suspicionless. An individual student was targeted on reasonable suspicion.[220] Furthermore, the search uncovered marijuana, and the student suffered criminal penalties.[221] The *T.L.O.* school officials conducting the search for mari-

212. 469 U.S. 325 (1985).
213. *Acton*, 115 S. Ct. at 2392.
214. *Id.* at 2391.
215. *Id.* at 2395-96.
216. *See id.* at 2386.
217. Throughout the *Acton* opinion, the Court cited *T.L.O.* to support their findings of fact and conclusions of law. For example, the Court cited *T.L.O.* for the proposition that the Fourteenth Amendment extends the constitutional guarantees of the Fourth Amendment to searches and seizures by public school officials. *Id.* at 2390. The Court also cited *T.L.O.* to establish that in the public school setting, "special needs" exist, thereby alleviating the practicability of a warrant. *Id.* at 2391. In addition, the Court explained that a school search based on less than probable cause was reasonable in *T.L.O.* *Id.* at 2391. The Court emphasized that in *T.L.O.* they rejected the notion that public schools, like private schools, exercise only parental power over their students. *Id.* The Court explained further that such a proposition "is not entirely consonant with compulsory education laws" and is "inconsistent with [the Court's] prior decisions treating [public] school officials as state actors for purposes of the Due Process and Free Speech Clauses." *Id.* at 2392 (citations omitted). Finally, the Court cited *T.L.O.* for the proposition that students generally have a lesser expectation of privacy than other members of the population. *Id.*
218. *T.L.O.*, 469 U.S. at 328.
219. *Id.* at 326.
220. *Id.* at 347.
221. *Id.* at 328-29.

juana were not furthering a special governmental need beyond law enforcement; the purpose and consequence of the search was criminal. This raised the question of whether school discipline was a special need in *T.L.O.* The answer is yes, with respect to the principal's search for cigarettes. However, the character of the second search for marijuana was undoubtedly criminal.

The warrant exception recognized in *T.L.O.* is not due to any administrative aspect of the search, but rather is an extension of *Terry v. Ohio*.[222] The Court's reliance on *T.L.O.* is flawed because *T.L.O.* applied *Terry*'s reasonableness test rather than an administrative search analysis.[223] The *Terry* decision authorized limited, warrantless searches of individuals, even when the purpose of a warrant would be furthered, on a reasonable suspicion of criminal activity, usually combined with warrant impracticability and a lesser expectation of privacy.[224] *Terry* only authorized such limited searches on a reasonable and articulable individualized suspicion of criminal activity; it never authorized a highly intrusive suspicionless search of the kind involved in *Acton*. Despite the temptation to combine these school search cases, they are factually and legally quite different. Because *T.L.O.* is a criminal search case, it is not controlling in an analysis of the constitutionality of *Acton's* administrative search; therefore, the Court's reliance on *T.L.O.* is misplaced.

In addition, by allowing such a highly intrusive search without individualized suspicion, the majority ignored the guiding principles established by precedent, concerning the proper interpretation of the Fourth Amendment.[225] Professor Thomas Clancy argues that the Court "has failed to attend to the basic task of understanding the [Fourth] Amendment. The Court must return to the fundamentals: history does provide guidance; the Fourth Amendment was designed to protect individual liberty; reasonableness does have meaning; and individualized suspicion is a core component of reasonableness."[226]

In addition, as the *Acton* dissent noted, it is a "great irony" that the evidence introduced by the District to justify suspicionless testing consisted of incidents recanting "particular, identifiable students acting in ways that plainly gave rise to reasonable suspicion."[227] The District argued on the one hand that individualized suspicion was impracticable, then on the other hand argued that officials were able to identify particular students—the individual athletes. Several Justices focused on this flawed reasoning in the District's oral argument; this inconsistency remains unresolved.[228]

---

222. 392 U.S. 1 (1968) (holding that a limited, protective, pre-arrest search for weapons by the police was reasonable if a reasonably prudent person in the same circumstances would justifiably believe the suspect posed a danger).

223. *T.L.O.*, 469 U.S. at 341-42.

224. *Terry*, 392 U.S. at 30-31.

225. *See* Carroll v. United States, 267 U.S. 132, 147 (1925) ("The Fourth Amendment does not denounce all searches and seizures, but only such as are unreasonable.").

226. Thomas K. Clancy, *The Role of Individualized Suspicion in Assessing the Reasonableness of Searches and Seizures*, 25 U. MEM. L. REV. 483, 635 (1995).

227. *Acton*, 115 S. Ct. at 2403.

228. *See* Oral Arguments at 6, Vernonia Sch. Dist. 47J v. Acton, 115 S. Ct. 2386 (1995) (No. 94-590).

The majority's decision also ignores the Court's prior decisions in *Railway Labor Executives' Ass'n* and *Von Raab*. These cases authorized full, intrusive, suspicionless searches, which demonstrated an overwhelming departure from the Constitution's original definition of reasonableness: a warrant supported by probable cause.[229] Nonetheless, these searches were reasonable in light of a compelling government interest beyond law enforcement. Likewise, because the District's urinalysis policy is highly intrusive, the District must demonstrate a compelling interest to survive a constitutional challenge. A legitimate or important interest is insufficient. Examples of compelling interests include railway collisions, as in *Railway Labor Executives' Ass'n*, and drug addicted, armed employees involved in front line drug interdiction, as in *Von Raab*. As the Ninth Circuit correctly explained, "The extreme dangers and hazards involved in the prior cases are simply not present here . . . . [The risk of athletic injury] is not a risk of the same magnitude as an airplane or train wreck, or a gas pipeline or nuclear power plant disaster."[230] The majority in *Acton* inexplicably lowered this threshold and did not adhere to precedent when it approved the Policy.

The majority held that athletes have a lower expectation of privacy than other students. This holding is flawed because a student-athlete does not lose his or her privacy by playing sports, in the way a railroad employee or a U.S. Customs Service agent may expect a deprivation of their privacy. Moreover, *Railway Labor Executives' Ass'n* and *Von Raab* require a compelling interest, despite a lower expectation of privacy. Without a compelling interest, the District's Policy does not pass constitutional muster. As the dissent correctly pointed out, nothing in the record demonstrated that a drug problem existed in the grade school James Acton attended. The evidence, therefore, did not support the majority's reasoning as it applied to James Acton.

Even assuming arguendo that a drug problem did exist in the middle school, one of the most glaring flaws in the Court's reasoning is that the Policy ultimately does not address the problem. Again, the District's interest is in discipline and athletic safety, not criminal enforcement of alcohol and narcotics laws. This is clearly distinguishable from the government's interest in *T.L.O.*, where the principal was clearly looking for evidence of criminal activity so that he could turn the evidence and student over to police.[231] Although illegal alcohol and drug use may have caused the discipline and safety problems claimed by District officials, the Policy was created out of disciplinary and safety concerns, not out of concern over the substances themselves. Only

229. U.S. CONST. amend. IV.

230. Acton v. Vernonia Sch. Dist. 47J, 23 F.3d 1514, 1526 (9th Cir. 1994); *see* International Bhd. of Elec. Workers, Local 1245 v. Nuclear Regulatory Comm'n, 966 F.2d 521 (9th Cir. 1992) (involving drug testing in the nuclear power industry); Bluestein v. Skinner, 908 F.2d 451 (9th Cir.) (involving random drug testing of airline personnel with safety responsibilities), *cert. denied*, 498 U.S. 1083 (1991); International Bhd. of Elec. Workers, Local 1245 v. Skinner, 913 F.2d 1454 (9th Cir. 1990) (involving random drug testing of employees working with natural gas, liquified natural gas, and hazardous liquid pipelines).

231. *T.L.O.*, 469 U.S. at 328-29.

when District officials recognized that student drug use triggered disruptive behavior did the District decide to implement the Policy.[232]

Furthermore, although the dissent warned the Court about casting away established constitutional principles based on public policy concerns, it appears as though the majority did exactly that.[233] Masking their own policy goal of furthering the "War on Drugs" behind an interest in promoting discipline and athletic safety in the Vernonia School District, the Court succumbed to political pressures.[234] Instead of adhering to established precedent, the majority approved a policy which allowed school officials to "engage in a 'fishing expedition' for drug and alcohol use [in furtherance of] a moral crusade."[235]

Perhaps the most distressing aspect of Justice Scalia's majority opinion is his vehement departure from his dissent in *Von Raab*.[236] While at first this departure appears chameleon-like, it becomes obvious upon deeper reflection, that Justice Scalia's change in position reflects merely a distinction between searches imposed on adults and those imposed on children. In *Von Raab*, Justice Scalia found that making an adult employee urinate into a testing jar was a constitutionally impermissible "invasion of their privacy and affront to their dignity"; however, in the context of children, he finds the same drug testing so admirable that he is willing to write a majority opinion espousing its virtue. In Justice Scalia's eyes, drug testing of a person's urine is an unconstitutional intrusive search when applied to an adult. When applied to a child, it is converted into a disciplinary necessity. The rights of children are suppressed while the rights of adults are exalted. This follows a general trend in our country to criminalize the conduct of children.[237]

---

232. Acton v. Vernonia Sch. Dist. 47J, 796 F. Supp. 1354, 1357-58 (D. Or. 1992).

233. *See Acton*, 115 S. Ct. at 2402.

234. As one commentator remarked:

> [T]he largely conservative ideology of the justices is matched by their views of the judiciary's role in society. Chief Justice William H. Rehnquist and Justice Antonin Scalia, among others, have spoken about the importance of leaving contentious issues to the political branches of government, at the federal level and below.
>
> . . . .
>
> Focusing on what [cases] the Court is not taking may miss the far more important fact that sometimes the justices set an agenda by concentrating attention on only a handful of key cases.
>
> That concentration happened during the 1994-95 term, when the court's conservative majority set the agenda for the entire term by shrewdly selecting a half-dozen key cases at the start of the term.
>
> . . . .
>
> Among the . . . petitions granted by the Court at the start of the 1994-95 term that produced decisions favored by conservatives [was] . . . *Vernonia School District v. Acton*.

David G. Savage, *Docket Reflects Ideological Shifts: Shrinking Caseload, Cert Denials Suggest an Unfolding Agenda*, A.B.A. J., Dec. 1995, at 40, 40, 42.

235. *Acton*, 796 F. Supp. at 1363.

236. For a discussion of Justice Scalia's dissent in *Von Raab*, see *supra* note 86.

237. This is evidenced by juvenile facilities which mirror the environment in prisons, and the overwhelming support for imposing stiffer sentences on juveniles:

> The sentencing guidelines do not apply to a defendant sentenced under the Federal Juvenile Delinquency Act. However, the sentence imposed upon a juvenile delinquent may not exceed the maximum of the guideline range applicable to an otherwise similarly situated adult defendant unless the court finds an aggravating factor sufficient to warrant

IV. CONCLUSION

In declaring the Vernonia School District's random, suspicionless, urinalysis drug testing policy constitutional, the majority stripped James Acton and other students seeking to participate in athletics of their legitimate expectations of privacy and security under the Fourth Amendment. Drug abuse is an overwhelmingly important societal problem that faces our entire nation. The Court, however, did not follow established precedent; rather, it based its decision on its own public policy view. Despite the Court's long held position that children do not "shed their constitutional rights . . . at the schoolhouse gate,"[238] this decision nonetheless demonstrates the Court's willingness to deny students the full protection of the Constitution and the Bill of Rights.

Joaquin G. Padilla

---

an upward departure from that guideline range. Therefore, a necessary step in ascertaining the maximum sentence that may be imposed upon a juvenile delinquent is the determination of the guideline range that would be applicable to a similarly situated adult defendant.

See United States Sentencing Commission, *Guidelines Manual*, § 1B1.12 (Nov. 1995); *see also* Elaine R. Jones, *The Failure of the "Get Tough" Crime Policy*, 20 U. DAYTON L. REV. 803 (1995) (discussing the shortfalls of implementing a "Get Tough" Policy in the United States); Barry Krisberg et al., *What Works with Juvenile Offenders?: A Review of "Graduated Sanction" Programs*, 10 CRIM. JUST. 20 (1995) (examining various programs adopted around the country which have studied the issue of juvenile offenders and the appropriate response to the problems raised by this issue); George B. Smith & Gloria M. Dabiri, *The Judicial Role in the Treatment of Juvenile Delinquents*, 3 J.L. & POL'Y 347, 360-65 (1995) (discussing how public perceptions concerning juvenile crime have generated a public sentiment toward "getting tough"). "These new laws and policies have included prosecuting younger children as adults for certain crimes, as well as imposing mandatory, longer and more restrictive placements of adjudicated delinquents and other young offenders." *Id.* One commentator questioned the effect on the entire juvenile justice sysyem:

> In recent years, many states have enacted laws specifically addressing the problem of serious and habitual juvenile crime. Several prominant commentators have interpreted this trend as an indication that society has rejected the juvenile court's traditional philosophy of rehabilitation in favor of more punitive, offense-oriented sanctions, and some have concluded that recent changes call into question the very viability of the juvenile court system.

Julianne P. Sheffer, Note, *Serious and Habitual Juvenile Offender Statutes: Reconciling Punishment and Rehabilitation Within the Juvenile Justice System*, 48 VAND. L. REV. 479, 481 (1995); *see also Keep the Receiving Home Closed*, WASH. POST, Aug. 19, 1995, at A20; Guy Kelly, *ACLU Files Suit over Youth Center*, ROCKY MTN. NEWS, Dec. 10, 1994, at 4A; Guy Kelly, *Youth Facility Bursting at the Seams*, ROCKY MTN. NEWS, Sept. 9, 1993, at 16A; Nancy Lewis, *Much of D.C. Youth Facility Without Hot Water*, WASH. POST, Sept. 23, 1995, at B3. *Cf.* Barry C. Feld, *Violent Youth and Public Policy: A Case Study of Juvenile Justice Law Reform*, 79 MINN. L. REV. 965, 1006-13 (1995) (reviewing the process of certifying juveniles for adult criminal prosecution); Catherine R. Guttman, *Listen to the Children: The Decision to Transfer Juveniles to Adult Court*, 30 HARV. C.R.-C.L. L. REV. 507 (1995) (reviewing the legal and policy implications of the recent wave of juvenile transfer laws). *See generally* Mark Curriden, *Hard Times for Bad Kids*, A.B.A. J., Feb. 1995, at 66 (examining the problems associated with the increase in juvenile crime, and the different responses to these issues).

238. Tinker v. Des Moines Indep. Community Sch. Dist., 393 U.S. 503, 506 (1969).